



# Sales Tax and Technology:

## Automated Solutions Help Meet Complex Requirements

BY BRIAN TERRELL, CPA

Why should CPAs be concerned about sales tax, and what effect does sales tax compliance have on your clients? Since sales tax is a pass-through tax, accounting professionals and business owners may put it out of sight and out of mind compared to federal income tax. However, the risks associated with the failure to comply with sales tax laws should not be underestimated.

To minimize the risks and avoid the sales tax audit, compliance must be addressed. More than likely, your clients are filing returns and paying their fair share – but are you completely certain they are complying, in the most efficient manner possible, with the extremely complicated state-by-state requirements?

### Communications and Information

Sales tax typically represents more than one third of a state's revenue; in many states, the percentage is much higher. According to 2007 rates from the Federation of Tax Administrators, seven states generated *more than 50 percent* of their income from sales tax – including Texas. In fiscal 2008, the most recently completed fiscal year, total tax collections in the Lone Star State were \$41.4 billion. Of this amount, sales tax accounted for \$21.6 billion, or 52 percent of total tax collections.

“The failure to properly collect and/or remit sales taxes can have devastating consequences, especially to small businesses; it sometimes

pushes them over the edge,” says **Ira Lipstet**, J.D., CPA-Austin, a partner with DuBois, Bryant & Campbell, LLP, in Austin, Texas. “Many times, there wouldn't be much of an issue if the records were in decent shape – something as simple as showing tax amounts paid or remitted.”

Although the general Texas four-year Statute of Limitations implies a similar period for record retention, Lipstet, a member and former chair of TSCPA's State Taxation Committee, recommends a minimum of six years – and frequently longer – because audits can sometimes take several years to complete.

**Kevin Koller**, assistant director of the Tax Administration Division for the Texas Comptroller of Public Accounts, agrees. More than four years is important for other reasons, too. “The state can go beyond this limit if the taxpayer did not file, fraudulent activity exists or there is gross error of more than 25 percent,” says Koller. “The failure to retain proper documentation for transactions and business activity almost always penalizes the taxpayer. The state is allowed to perform estimates and disallow exemptions when proper documentation is not retained.”

Communications is key and affects all parties involved. At the state level, Koller wants to ensure the lines of communications are kept open. “The

Comptroller's office is committed to providing clear communications and working toward a resolution of issues," he says. "If you disagree with the Comptroller employee, feel free to discuss the issue with the employee's supervisor or manager. In the case of audits, you can also discuss the case with an Independent Audit Reviewer (IAR). IARs are not employees of the Audit Division and have been very useful in reconciling issues without a formal hearing process."

On the CPA/client side, Lipstet encourages constant discussions. "The tax advisor should be aware of sales and use tax collection obligations, but sometimes, there has never been a conversation on that topic between the advisor and the client," says Lipstet. "In general, many CPAs are not focused on sales tax. If not addressed, however, the client may have a different expectation than the CPA as to whether sales tax advising is part of the engagement. So, from a client's perspective, there may be a presumption that because their CPA is working in tax, the professional is educating or advising the client on sales tax matters."

### The Case of the Misplaced Box

Lipstet's practice focuses on tax law; a significant part of his practice deals with Texas state and local tax controversy matters. One engagement several years ago involved an auto service business with multiple locations that was forced to shut down for economic reasons. The owner filed bankruptcy. However, the bankruptcy proceedings were dismissed by the court. Consequently, asserted tax liabilities that might have been addressed if the bankruptcy had proceeded to conclusion once again became live issues. Subsequent to the bankruptcy dismissal, the Texas Comptroller issued a notice to the company president saying there was a failure on the part of the company to remit approximately \$1 million in sales tax

shown as due on sales tax returns that were previously submitted. This was considered to be a "trust fund" tax – a tax that was collected, but not remitted. As a result, the asserted tax liability was claimed to be a personal obligation of the so-called "responsible person" – an individual who had a legal obligation and ability to make sure payment was made – but did not do so. The Comptroller further asserted this person was the company president and demanded the \$1 million from her personally.

"The client insisted the company *did* pay sales tax reported on the returns and to look at the records for proof," says Lipstet. "However, the bankruptcy trustees had the records shredded. We scrambled around and fortunately found a couple of remaining boxes in storage that contained company records."

Lipstet determined tax payments had been made to the Comptroller, but under different account numbers. Tracing a few of those showed the proper accounts were not credited. As a result, the liability was reduced from \$1 million to \$20,000. "A liability equal to 8.25 percent of gross receipts, plus interest on underpayment and possibly penalties, has the potential to be a lot more important to businesses than people give it credit!" says Lipstet.

### Complex Boundaries and Rules

In order to comply and address state requirements, CPAs and their clients must understand several concepts. First, there is "nexus." If a company has a "warm" body – salespeople visiting the state, service personnel or even contractors – it will likely have nexus, but watch out! Apart from this simple definition, there may be other circumstances that could get the business in trouble. A company's CPA is the best source to sort out the details.



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Second, Texas has an origin-based local tax. According to CCH, only nine states have this structure. Origin states view sales tax transactions in the state as payable in the jurisdiction where the item is sold. Destination states, on the other hand, view tax as payable based on the seller's location if that is where the item is received. Otherwise, taxes are payable to the jurisdiction to which the item is delivered.

Third, there is simplification and uniformity through the Streamlined Sales and Use Tax Agreement (SSUTA). Even though many states have adopted SSUTA, Texas has not. Used since March 2000, this is a voluntary effort by state governments to simplify and harmonize sales and use tax collection and administration. It was designed to encourage efforts at the federal level to allow states to require remote sellers to collect sales tax. Texas, for example, collects more than 50 types of taxes and fees.

“Sales tax is the largest tax the agency collects, and we constantly reach out to taxpayers big and small to offer them the information they need,” says Koller. “This is done through forms and publications, data retention, policy analysis, taxpayer seminars and a phone bank. Enforcement officers, auditors and hearing attorneys are also important links in the process of tax compliance.”

There are two basic technology components associated with sales and use tax: calculation, and returns and remittance. There are, on average, 1.9 sales tax rate changes *per day*, and with thousands of tax rates for more than 10,000 sales and use tax taxing authorities, maintaining these rates and numerous changes is nearly impossible for companies doing business in multiple states. In addition, the rules for taxability and calculation

vary from state to state, and in local areas in some states. Keeping up with different Sales versus Seller's Use tax rates for the exact same jurisdiction – and determining applications to a

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specific sale – is extremely overwhelming. Automated tax calculation solutions that maintain the data for all the rates and rules are a necessity for businesses that operate in a multi-state environment.

A listing of basic sales and use tax state and local returns can exceed 450 forms, and the typical filing frequency is monthly! For a multi-location retailer in multiple states, it is not uncommon to file more than 100 sales/use tax returns per month. Nationwide, retailers can easily file over 1,000 sales/use tax returns every single month! As a result, companies doing business in multiple states with limited resources have no choice but to find an automated returns solution.

### SaaS = Total Automation

Understanding the complex calculation, returns and remittance scenarios leads to the question: How do companies actually prepare their sales tax reports and payments? Some companies may calculate sales tax and prepare reports through manual or hybrid solutions. In a “manual” environment, your clients load state, county, city, and local tax rates into their accounting software, and then manually update the tax tables for rate changes every time they occur in each jurisdiction in which a return is filed.

In a “hybrid” situation, clients subscribe to a rate table update service that populates the tax rates in their accounting software for all jurisdictions in which they file. Your clients manually update individual item taxability and customer exemption status and administer the rules.

Manual and hybrid solutions are cumbersome and mistakes frequently occur if work is not checked and double-checked. A fully automated solution, on the other hand, leverages the significant advantages of the Internet-based Software-as-a-Service (SaaS) model. SaaS is suited to handling constant rate and jurisdiction changes because all changes are tracked by a central service accessed through the Internet. You or your clients must ensure unique company settings – nexus, product taxability and exemptions – are updated within the system with web-based tools connected to the accounting software at the appropriate points. As a result, clients receive effortless consistency and accuracy with every sales tax calculation.

Automated solutions should be SSUTA-certified to ensure complete compliance. Even though Texas has not chosen to adopt SSUTA, the technology certification provided under the agreement still benefits Texas residents. Currently, four SST-certified service providers exist in the marketplace: SpeedTax, ADP Taxware, Avalara, and Exactor. With a SaaS sales tax solution, your clients' accounting application continues to function as the repository for the general ledger, and balances information, invoices, payments and customer lists. The sales tax solution is activated by automated triggers built into transaction processing that seamlessly interface with your clients' accounting package.

### How to Advise Clients

In some cases, a CPA may want to form a relationship with another CPA experienced in sales tax matters to help his/her clients stay in compliance. Also, Koller recommends visiting the Comptroller's website, [www.window.state.tx.us](http://www.window.state.tx.us), for information and other resource data. In addition, one caution he gives is to make sure a client who buys a business requests a Certificate of No Tax Due for the previous business.

“If clients buy an existing business, the inventory of an existing business or the name and goodwill of an existing business, they are liable for the sales tax owed by the business unless they get a certificate from the Comptroller before the purchase,” says Koller. “If they did not get this clearance before buying the business, if taxes are owed and the previous owner has failed to pay those taxes, the new owner could be required to pay any taxes, interest and penalties due.”

In addition, CPAs can start asking clients more questions. Chances are, your clients would benefit from implementing precautionary steps to reduce the risk of penalty and audit, but their limited knowledge of sales tax and its potential risk prevents them from even raising their concerns with you.

You should educate your clients about this important area. Once clients have done some basic examination into their sales tax needs and practices, it's time to explore the options to improve their practices.

You can learn more about certified solutions. Determine the pros and cons of each model and when they may make sense for your clients. There are distinct practical, cost and compliance benefits of each model, and your clients' specific situation should be reviewed to determine the best solution for their needs.



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