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Inside

Tax Talk

"Basically, the fiscal crisis for a majority of states, with the exception of maybe two, is generally over. Most of the states are sitting on surpluses. The panic and starvation for revenue is in the rearview. Various states, the pressure they may have been putting on their Congressional representatives has receded. It probably shouldn't be surprising that those two things correlate. It may be a long time before the Marketplace Fairness Act is passed."

— **Joe Schmidt**, state and local tax

Déjà Vu? Injunction Stalls Colorado Remote Seller Law

Be proactive with system upgrades, avoid risk

Colorado's use tax notification law has been blocked by a Denver district court judge's preliminary injunction—and not for the first time. The latest injunction came down Feb. 18, 2014, and follows the lifting of a similar injunction on Dec. 10, 2013 by a federal appeals court. The full case has yet to be heard, leaving tax compliance professionals scratching their heads as to whether compliance will be necessary for the embattled law.

The law requires companies that have no physical presence in Colorado, but make remote sales to residents of the state, to notify customers of their responsibilities to pay use tax. It also requires retailers to submit an annual report of all such customers to the Revenue Department. The controversial law has never been enforced, due to an injunction shortly after its passage in 2010. *SUTM* spoke with two tax advisors to determine how corporate taxpayers can respond to the uncertainty.

Some take "wait and see" approach

"No client likes to have to wait and see what's going to happen in court," said **Benjamin A. Blair**, an associate with **Faegre Baker Daniels**/Indianapolis. "This would be a substantial expense on their side, of having to go through and change all their systems to reflect Colorado's requirements," he explained.

However, Blair thinks the history of the case bodes well for taxpayers. "Based on what happened in federal court, it is at least a little more than 50% likely that the **Direct Marketing Association** [the trade group challenging the law] will end up being the victor," he predicted. He thinks many companies are holding off on any major upgrades to their invoice and accounting systems until the final decision comes down.

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Ensuring Proper Input Of Sales Tax Data And Documents

Data strategies essential for accurate returns, valid exemptions

Managing tax data is a vital and complex component of sales tax compliance. This month, in the second of a two part series, *SUTM* will explorehow to ensure data and documentation is correctly input into tax and accounting systems. In a recent webinar sponsored by *SUTM,* **Ken Stites**, a principal with **Stites Tax Consulting**/Round Rock, Texas, discussed those issues.

The key to managing data, according to Stites, is making sure that data is available and easily accessible in the future. "Recently, I had a client who changed reporting processes midway through an audit period. The auditor needed access to older transactions, but the information was not available," he explained. In the end, no one at the company knew how to access the data, so a former employee was called in to resolve the situation.

The moral? Don't lose track of data just because the return has been filed. "If you have that kind of change, make sure provisions are made for storage of data and make sure systems are in place to access it" until the end of the applicable state's statute of limitations, Stites advised.

Apart from that extreme example, Stites said that more often a tax department may have the data, but simply have to go through too much trouble to get it. "It's important to have access to any invoice," he said. To that end, your system should be able to retrieve invoices based on any field, such as customer name, invoice number, or date of transaction. For instance, if a single customer's invoices are causing a problem, the ability to pull invoices for all transactions with the customer is useful.

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Direct Marketing Association

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Blair was quick to point out that only companies able to absorb the risk of potential penalties and sudden upgrade expenditures should take the "wait and see" approach. More risk averse businesses may opt to upgrade systems proactively, especially considering how many states have copied Colorado's approach. "Colorado is not the only state that has some level of notice or reporting requirements," he pointed out. "It's just the one that's managed to get this far in court."

To the extent that companies have exposure in several of these states, a full system upgrade might be a worthwhile investment, regardless of which way the wind blows in Colorado. (For a list of all the states with use tax notice laws, see p. 3 of this edition).

Revenue Dept. forestalls penalties

The clock is not exactly ticking for compliance with Colorado's law, as Joe Schmidt sees it. "Colorado Revenue Department officials have not made it a secret that they weren't chasing people down," the tax practice leader in the Denver office of **Grant Thornton** told *SUTM*. The Department has released notices informing taxpayers that no fines will be levied for failure to comply with the law for the 2013 tax year. "They wanted to let this play out," Schmidt said.

Still, Schmidt doesn't advise remaining behind the ball if your company makes sales to states with remote use tax notice or sales tax collection requirements. "I would say that it is something that the tax function in any number of e-commerce companies needs to affirmatively address," he said. "They need to make an investment so that when the switch is turned on, they are capable of collecting and remitting the necessary sales tax," he advised.

In Schmidt's opinion, the frequent filing requirements for most state sales taxes, coupled with how suddenly new laws are often passed, requires a proactive plan so that a sudden requirement in a new jurisdiction doesn't catch the tax department off guard. "They may not need to buy software today, but they need a plan in place," he said.

Even in a best case scenario, with all hands on deck, ramping up to collect sales tax in a new state could take up to six months, in his estimation, for an e-commerce company with minimal sales tax collection responsibilities. That process involves tasks like selecting software, integrating it with the existing system, how much to pay for consultants, what changes to make to accounting systems, how to train current employees on changes to billing and invoices.

For a company already paying sales tax in several states, the investment could be less. "It's really a judgment as to when to be ready for it as opposed to if," Schmidt said, since states aren't giving up on new approaches to taxing online sales anytime soon.

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Exemptions: Documentation is key

Documenting exemptions is one of the toughest aspects of sales tax data management. Partly, that's because sales tax regulations lag behind technology and business development, Stites opined.

One example is software delivered via "load and leave," in which software is uploaded to a customer's computers without any exchange of tangible personal property. Some states exempt such transactions, but be careful: the burden of proof is on the taxpayer to document such exemptions.

To that end, Stites recommends retaining thorough documentation for exempt transactions, including contracts, project proposals and correspondence between the client and the sales staff. That depth of information should provide sufficient proof to document exemptions, beyond an invoice. Most importantly, that information "needs to be maintained in a retrievable form," Stites said. "It needs to be accessible and documented."

Of course, collecting and maintaining exemption certificates is also vital. "Often, businesses rely on the sales force to collect that documentation," Stites said. The problem there is that "a lot of folks are not in tune or may not even care about the sales and use tax process, which therefore challenges the authority of the documentation." To that end, proper training of sales staff is key.

Once exemption certificates are collected, they need to be filed in a neat and organized fashion. "In my experience, electronic storage is best, as long as it's like any filing system," said Stites. In other words, make sure there is an easy way to retrieve certificates by date, or customer, or transaction, as needed. And document those policies and procedures for collecting and retrieving certificates so staff turnover doesn't interfere with compliance.

According to **Mike Dillon**, president of **Dillon Tax Consulting**/Annapolis, Md., similar difficulties can trip up project-based tax exemptions such as those offered for manufacturing and r&d operations. Dillon worked with a client claiming manufacturing exemptions not long ago. "They had to go through, as part of the audit, purchase by purchase and get people from the facility, engineers and employees, to verify they were purchased pursuant to an exempt project," he explained. "Some simple front end planning to map and capture that data would have been able to reduce the cost of having to do so during audit," he said.

Verify data when filing returns

Other issues that come up in filing returns include discovering discrepancies in the month-to-month total, taxable, or exempt sales in a particular jurisdiction, Stites said. While that type of sudden shift in monthly sales might have a real-world explanation, he advises investigating to make sure it isn't an error in the data.

Also, Stites recommends double checking software platforms to make sure that the information for jurisdictions, products, and customers have been input properly. "Software itself has tools to establish taxability and rates, but it's only as good as the info you give it," he said.

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