

Use Tax Assessments on the Rise

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To our Clients and Friends of the Firm:

We are writing you about an often misunderstood tax, “use tax.” Use tax is regularly the cause of large tax assessments. Use tax is the evil alter ego of sales tax. Tangible items purchased by consumers are generally subject to sales tax. If sales tax was not charged on the initial sale, use tax would become due in the same amount the sales tax would have been, if the vendor had charged it.

SALES TAX

Most of us are familiar with sales tax. We pay it when we buy cars, clothes, vacuum cleaners, fast food, and most other tangible personal property. In many states sales tax applies to varying services. For examples laundry services are subject to sales tax in North Carolina and South Carolina, but not in Georgia.

USE TAX

Many companies are happy when they avoid sales tax by purchasing things like computers or supplies online, but many are unaware that a use tax liability is generated as soon as they receive the property.

Use tax is referred to as a compensating tax. If sales tax is not collected by a vendor, use tax compensates for this by becoming due. The primary difference between use tax and sales tax is that sales tax is paid to the vendor and use tax is generally paid directly to the government. The use tax rate is generally the same as the sales tax rate so the amount of tax due is equal to what it would have been if sales tax had been charged.

Because taxpayers are often unaware of this tax or not properly self assessing, states center a great deal of attention on this issue. When auditing businesses auditors focus on purchases made from out-of-state vendors and purchases made online.

They will also look closely at purchases where determining whether sales or use tax should apply is complicated. For example, purchases of checks by a financial business may or may not be subject to tax depending on what the business does with the checks. If the checks are given to customers, sales or use tax is due when they are purchased from the vendor.

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USE TAX (continued)

Alternatively, if the checks will be sold to customers, sales and use tax would not be due on the initial purchase because sales tax will be collected from the businesses customer.

Database subscriptions, software licenses, and software maintenance and support agreements are also items that auditors will surely review. Different states treat these items differently for sales and use tax purposes so vendors and end users are often confused as to whether sales or use tax is due.

For example, load and leave software (where the vendor downloads the software from a disc to the customer's computer at the customer location) is subject to sales tax in South Carolina but not in North Carolina. These fine gradations in taxability make it difficult for taxpayers to comply which attract the attention of auditors.

Other areas of interest for auditors include supplies, computers and peripherals, equipment, furniture, promotional items, and signage among other things.

AUDITS AND ASSESSEMENTS

In this climate of state deficits, sales and use tax audit activity will only increase and auditors will become more aggressive. In order to avoid tax assessments and the related penalties and interest it is important to have processes in place to properly self assess and pay use tax. These processes vary from business to business depending on purchasing volumes, purchasing patterns, and staffing. It is important to find the right balance in order to report as accurately as possible while using resources efficiently.

We are experienced in helping clients develop procedures to pay the proper amount of use tax and avoid unwelcome tax assessments. Please feel free to contact us with any questions or if you would like assistance in putting use tax reporting processes in place.

Regards,

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