

TAX AUDIT DEFENSE STRATEGIES Q&A

ED BEN, DIRECTOR, TRANSACTION TAX PRACTICE, SC&H GROUP

Companies are often challenged when it comes to state and local tax audits. Auditors take a “guilty until proven innocent” approach to assessing tax, penalties, and interest, with the burden of proof in rebutting such assessments falling to the taxpayer.

In addition, most auditors ignore tax overpayments, leaving it up to the taxpayer to engage the right expertise to help reduce assessments asserted by the state.

Following is an interview with Ed Ben, Director, Transaction Tax Practice, SC&H Group, who shares some insights into why companies should be proactive and aggressive in their Audit Defense strategy.

Q: **What are the biggest challenges taxpayers face when looking at the transaction tax terrain on the state level?**

A: First, major corporations that do business in multiple states face a highly complex tax landscape, with each state having its own taxing definitions, varying exemptions, and differing interpretations of seemingly similar statutes.

Further adding to these complexities are the 9,600 taxing jurisdictions in the country, each with its own state, local, county, and special district rates to consider. For businesses with a vast footprint, incorporating these complex nuances into the compliance and reporting process can be difficult. If not implemented correctly, a compliance and reporting system can lead to underpayments or overpayments of transaction taxes.

The fundamental building block of a strong audit defense strategy lies in ensuring that a

corporation’s compliance and reporting process is implemented so that only the correct amount of tax is captured and reported. Cutting corners during a system implementation, or not developing a well-documented process, will only cost you money in the long run.

Q: **In addition to that fundamental building block of audit defense, what else does a tax manager need to be aware of when developing a good audit defense, and why it is important to major corporations?**

A: In light of today’s economy and changing consumer purchasing preferences (online vs. brick and mortar, digital vs. tangible products), state tax auditors are as aggressive as they have ever been. With sales & use taxes comprising more than 30% of many states’ revenues, auditors are doing their best to preserve the tax base. Today’s fast-paced sales environment doesn’t allow for businesses to stop and figure out the right application of

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tax to transactions on the fly. This environment should lead tax managers to understand that a proactive approach to audit defense strategy is imperative.

Managers need to understand that tomorrow's audit starts today, and that what we do today will make a difference during an audit three years from now. Once you have a solid reporting process in place a good proactive audit strategy should inform all you do. A sound strategy starts by focusing on the basics. Understand your company's business activities: where and how it is conducting business, buying and selling property. Make sure that claimed exemptions from the tax are adequately supported by proper documentation. Test procedures and review supporting documentation on a regular basis, and make certain that you keep up with changes in the law and its interpretations. After all, you'll have to do this in an audit. So be prepared and know where issues might occur ahead of time. This approach, implemented to cope with the complex curtain of multi-jurisdiction sales tax law, the economy, consumer buying patterns and the daily rush of business, will lead to lowered exposure and audit risk.

But these same market forces often leave companies short staffed and tax managers with little time to be proactive. If a taxpayer finds itself in such a position, it shouldn't wait until it gets an audit notice to pay attention to these issues. Instead, the company should bring in an expert with the broad range of experience necessary to identify and correct areas of

sales tax exposure. This expert also should have the right mix of expertise to identify and correct procedures that may lead to sales tax overpayments and recover erroneously paid taxes from the authorities.

Q:

In spite of implementing best practices a taxpayer can still wind up with a large, unexpected assessment. What leads to these assessments being issued?

A:

State tax laws result in an uneven playing field for taxpayers. Auditors, whose job it is to enforce collections and raise revenue for the states, are good at employing a state's taxing statutes to raise the most revenue possible. Don't forget that auditors are typically evaluated on how many audits they close and how much revenue they raise.

As a result of the tools at their disposal and the pressures they are under, many auditors don't take the time to learn about the taxpayer's business or the nature of the transactions they are examining. To illustrate, if a company can't produce a couple of invoices during the audit, which tends to happen, an auditor relies on a tool that automatically allows taxing those transactions – even if the taxes have actually been paid. If an invoice isn't clear as to what was purchased or how it was delivered, rather than take the time to really dig into it, the auditor may just tax it. Remember – guilty until proven innocent.

Another factor that can lead to an inflated assessment is incorrect usage of statistical sampling methodologies in the audit. If an

A: auditor or taxpayer doesn't understand the population and relies on erroneous data or conclusions before drawing a sample from which an assessment will be extrapolated, disaster can ensue. And when the assessment is issued, the taxpayer has the burden of proof in refuting it.

Q: **When selecting an advocate to assist with audit defense, what factors distinguish SC&H from the rest of the field?**

A: First, SC&H has a solid track record of reducing tax liabilities in a number of jurisdictions for clients in a variety of industries. This geographic experience with the law and industry knowledge of business practices provides a level of familiarity with taxing authorities and allows for our nuanced understanding as to how the law should be most favorably interpreted and applied to our clients' situations.

The proof is in the numbers. For example, we worked with a large global telecommunications provider that was assessed \$4 million in state sales taxes. Upon reviewing thousands of pages of documents, we developed a deep understanding of the underlying transactions. This allowed us to build a solid case as to how the law should be applied to these complex transactions. SC&H reduced the liability to \$80,000 on appeal.

In another instance, a client in the hospitality and lodging industry was assessed \$200,000. Upon developing a comprehensive understanding

of the corporate structure, SC&H identified circumstances that even the company's in-house counsel had missed, leading to suspected overpayments of \$250,000 and undermining the auditor's assertion of tax. During the appeals process, the auditor commented that he wished SC&H had been engaged during the fieldwork so we wouldn't have had to go through the appeal process. Our client's assessment was fully abated and the company received its \$250,000 refund.

These examples, in addition to SC&H's sophisticated understanding of statistical sampling techniques, audit methodologies, and the appeals process, highlight our ability to minimize liabilities and manage audit risk on a consistent basis. I like to use a neurosurgeon analogy when describing what SC&H offers. When a patient has a brain tumor, the general practitioner will turn to a specialist for diagnosis and treatment. Likewise, when a taxpayer faces an audit, the accountant should turn to a specialist for assessment reduction and mitigation of audit risk. Much like the neurosurgeon, SC&H has the highly specialized skills necessary to achieve the optimal outcomes for its clients. ■

ABOUT ED BEN *Ed is a Director within SC&H Group's Transaction Tax practice, where he directs and performs reverse audits, audit defense, transactional tax planning, nexus studies, and voluntary disclosures for his clients. While at SC&H Group, Ed has saved clients tens of millions of dollars through successful representation in jurisdictions across the U.S. In addition to his Sales & Use Tax expertise, Ed and his team help clients navigate other, transaction tax liabilities unique to specific taxing jurisdiction, including Business, Professional & Occupational (BPOL) and Local Gross Receipts taxes. Beginning his career with a "Big 4" international accounting firm, Ed gained a solid base of knowledge in state and local tax consulting practices before joining SC&H in 1996. He has been voted as one of Maryland's Top CPAs by peers and clients in Smart CEO Magazine's annual survey, and is a sought after speaker, having presented on a wide range of Sales & Use Tax topics for the Council on State Taxation (COST), Institute for Professionals in Taxation (IPT), the Tax Executives Institute (TEI), Lorman Education Services, Accountants, Inc., and other professional, business, and industry groups.*

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