The Best Way to Resolve Sales Tax Problems
-by Ned Lenhart, President, Interstate Tax Strategies, P.C.

For the past 25 years, I've seen a lot of great companies get themselves into significant sales tax problems because they failed to follow some of the basic advice I've given in the previous five articles. These problems surfaced at companies of all sizes. Sales tax deficiencies seem to be an equal opportunity problem. Companies who actively manage their sales tax processes realize that there will always be areas of exposure and that this liability is just a "cost of doing business". These businesses can tell you where the problems are, what they are doing about them, and how much their risk is. I have no problem with this approach. As you might imagine, this is a very small percentage of the business.

The vast majority of businesses manage sales their tax on an "ad hoc" basis and only as issues arise. If an audit occurs, then they deal with the issues in that state. If a customer complains about tax, the company fixes that customer's issues. At some point, these one-off problems can accumulate to the point that something dramatic needs to be done. In some cases, the state conducts and audit and discovers the problems for you. Depending on whether your business is registered for sales tax will determine how far back the state will assess you for back tax. In addition to the tax that is due, interest and penalties will also be due. In some cases, interest and penalties can be 50% of the amount due.

If you know your company has a material sales tax problem and you don't want to be subject to the disruption and cost of an audit, there are a couple of options you can pursue to resolve the issues. The primary and most popular option is called a "voluntary disclosure" agreement (VDA) which allows taxpayers to come forward and pay the taxes they owe and have penalties and, sometimes, interest abated. This type of option works best for unregistered companies who owe tax for many years. Under the VDA process, states will normally limit the tax period to 3 or 4 years. For companies that have liabilities for a decade or more, the VDA can be a huge savings of tax. States normally require that interest be paid but they will abate the penalties. The primary proviso is that your company cannot have been contacted by the state at anytime during the "look back" period. If, after the VDA has been completed, the state finds out that the company had been notified by the state at some prior period, then the VDA is off and chaos ensues. The VDA negotiations are done anonymously through a 3rd party so that the taxpayer's identity is not revealed until the final agreement is signed.

Many states will allow a similar type of process for companies that are currently registered for tax. While this may not be a pure VDA, the states will normally allow registered businesses to come forward and pay back taxes without penalty. In most cases the VDA look back rules apply to tax that has not been collected from customers or to use tax that is due on purchases made by your company. If tax has been collected but not remitted, there is normally no limited look back because these taxes are "trust fund" taxes due the state. A careful analysis should be done before initiating a VDA.

Another, and perhaps less attractive, option to the VDA is the "tax amnesty" programs that appear occasionally. While the amnesty programs generally provide relief from penalty, they normally require that all the taxes be paid. In many cases, they do not include the current tax year. For a company that could owe 8 years of sales tax if audited, the amnesty program would require that 8 years of tax and interest be paid in exchange for the abatement of penalty. Under most VDA programs, the same taxpayer would only owe 3 years of tax and interest and would also get the penalties abated. In some cases, amnesty programs are open to taxpayers who have been contacted by the states already; this may be one of the few advantages of amnesty over the VDA.

If your company believes it has not been in compliance with the tax rules as it should have been and is worried about audits going back 5, 8, or 10 years, then pursuing VDAs may be an appropriate and more affordable option to pursue than to simply wait for the state to audit you.

A note about the author: Prior to starting Interstate Tax Strategies, P.C., Ned Lenhart served as Director of Multistate Tax Services for Deloitte's Atlanta office. He served as Director of the Missouri Department of Revenue's Compliance Division and led civil and criminal tax enforcement efforts; and served as Deputy Director of the Missouri Division of Taxation. He is a licensed CPA in multiple states and an active member in AICPA and GSCPA.

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