

Avoiding Audit Nightmares: Sales Shipped Out of State

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Introduction

- **Wade's Background**
 - 15 years of State & Local Taxation experience
 - Started Downey, Smith & Fier in April 2002
 - 6 years with Deloitte in Los Angeles as a Senior Manager
 - 5 years as Senior Auditor with California State Board of Equalization
- **Downey, Smith & Fier / Services**
 - Specialize in State & Local Tax Consulting
 - Audit Defense and Representation
 - Settlement / Audit Appeals
 - Tax Recovery





- Phone rings
 - You answer: “Hello”.
 - Your stomach drops.....
 - *“This is agent Smith with the Nevada Department of Revenue. Your business has been selected for a routine sales and use tax audit.”*
 - ARE YOU READY?
 - Was the tax collected remitted?
 - For every claimed exempt sale, do you have:
 - A resale certificate? Or
 - Shipping documentation? Or
 - Customer statements regarding use
 - Do you keep information that could lead to additional questions or scrutiny of claimed exempt interstate commerce sales?
 - Customer profiles, what addresses are maintained
 - Shipping address information, for example:
The Wynn, Las Vegas, NV (c/o Mr. Jones)

Overview



- State & Local Excise Taxes
 - Sales Tax
 - Use Tax
- Administration of Tax
 - Taxable presumption
 - Exemptions
 - Sales for resale
 - Interstate Sales (in-state verses out-of-state customers)
 - Taxes should not be a cost, but an administrative burden
- Customer representations
 - Pay no tax if delivered out-of-state
 - Are interstate sales subject to any tax?
 - Tax liability is not based on collection of tax

Type of Taxes Involved



- Sales Tax
 - Imposed on taxable sales of tangible personal property
 - Passage of title
 - For consideration
 - In-state transactions (buyer and seller in same state)
 - Legal obligation of retailer
 - With right to collect reimbursement from customer
- Use Tax (complimentary to the sales tax)
 - Imposed on the use of tangible personal property
 - Applies when sales tax not collected (in destination state)
 - Legal obligation of the purchaser
 - Reported by the purchaser

Administration of Tax



- Sales and Use Tax Administration
 - All sales presumed taxable
 - Opposite of US Justice System – “Guilty until proven innocent”
TAX IS DUE UNTIL YOU PROVE EXEMPT!
- For Retailer, **sales tax** should be limited to an administrative burden
 - However, when exemptions are denied, the retailer may be held responsible for the tax
 - Sales tax becomes a COST with interest and penalties.
 - When an exemption is denied, it is extremely difficult after the fact to recover the tax
 - Recurring customers – difficult and may strain customer relationship
 - Non-recurring customers - Nearly impossible
- Main Exemptions Claimed by Jewelers
 - Sales for Resale
 - Sales in interstate commerce
 - Requirement:
 - Property shipped directly by retailer to point outside state

Exemption Sales for Resale



Overview and Requirements of Exemption:

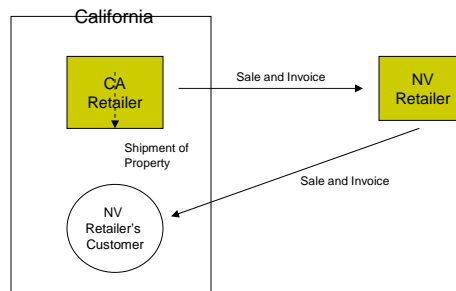
- Transaction where purchaser will resell the property being purchased (generally customer is another retailer)
 - Must be resold prior to use of property
 - Sale should be supported by formal certificate issued by purchaser, certificates may be:
 - State specific
 - Multi-jurisdictional
 - Certificate taken timely and in good faith **legally transfers** liability for tax to purchaser
- Form and Affect of Certificate
 - Certificate should generally include the following:
 - Name and registration number of purchaser
 - Description of property being purchased
 - Purchaser's business type (must be consistent with sales of property being purchased)
 - Statement that property will be resold
 - Date and signature
 - Certificates apply prospectively only, therefore should be taken timely
 - Some states require certificate to be provided within 30 days of request (or transaction is taxable)

Exemption Sales for Resale (Continued)



3rd Party Drop-Shipments (Beware!)

- Many States do not allow a resale certificate to be accepted for in-state delivery on behalf of an unregistered out-of-state retailer that requests delivery directly to its customer.
- For example, CA retailer sells diamond ring “for resale” to Jewelry Store in Las Vegas who requests ring be delivered to its customer in CA. The sale will only be an exempt resale if the Las Vegas Store is registered to collect CA tax. If not, California treats the in-state delivery as a taxable sale.



Exemption Sales in Interstate Commerce



Overview and Requirements of Exemption:

- Customer requests physical shipment of property to another state or country
 - Exemption based on goods being placed in continuous stream of commerce
 - Delivery to customer in store is taxable even if subsequently exported by customer
 - Immediate shipment following transfer of title
 - Holding property after title passage may nullify exemption
- Exemption Support
 - Sales must be supported by shipping documents
 - Fedex or UPS shipper copy may not be sufficient, yet provides retailer ability to get shipping confirmation
 - Customer's residency may impose additional requirements
 - Customer statement that property will be used out-of-state may be required

Exemption Sales in Interstate Commerce



Common Audit Questions

- Is insurance sufficient to cover value of property that was shipped?
 - Purchased insurance from carrier or Seller's general policy
 - Lack of Insurance creates additional scrutiny
- Why is delivered to different from purchaser's address?
- Why is property being shipped to temporary location, such as a hotel or resort?
- Is customer a resident of origin state (purchaser known to be resident)?
 - On face of invoice, what address or phone number is noted?
 - What address exists in customer database or profile?

Exemption: Sales in Interstate Commerce (continued)



Purchaser known to be a resident of Seller's (or origin) State

- Some states require a written statement from the customer that property will be used outside origination state.
 - Without timely statement, the sale (or purchase) is presumed to be taxable, even though the property was shipped
 - CA – Section 6247
 - NV – Section 372.704.7
 - After the fact certificates may be considered self-serving and not accepted
- Statements should include (sample attached):
 - Customer's residency
 - Statement of good faith
 - Property purchased for use outside origin state
 - Assumption of liability if information not accurate
 - Signature

STATEMENT PURSUANT TO SECTION 6247 OUT OF STATE DELIVERY



SALES INVOICE # _____ DATE _____

THE UNDERSIGNED REPRESENTS THAT THE ITEM(S) INCLUDED ON THE ATTACHED INVOICE WERE PURCHASED FOR USE OUTSIDE OF THE STATE OF CALIFORNIA, INCLUDING STORAGE, USE OR OTHER CONSUMPTION.

THE UNDERSIGNED CERTIFIES THAT HE/SHE IS A CA RESIDENT (NON-CA RESIDENT) , AND THAT THE ITEMS INCLUDED ON THE ATTACHED INVOICE ARE BEING SHIPPED TO THE FOLLOWING OUT-OF-STATE ADDRESS:

STREET: _____
 CITY, STATE: _____
 RECIPIENT (IF DIFFERENT, EXPLAIN): _____

***** NOTICE TO PURCHASER *****

ABC JEWELER'S ACCEPTS THIS STATEMENT IN GOOD FAITH, IF THE ITEMS PURCHASED FOR USE OUTSIDE OF CALIFORNIA ARE USE IN CALIFORNIA OR IF THE INFORMATION HEREIN IS DETERMINED NOT TO BE ACCURATE, THE UNDERSIGNER ASSUMES ALL LIABILITY FOR THE PAYMENT OF ANY APPLICABLE CA TAX, PAYABLE DIRECTLY TO THE BOARD OF EQUALIZATION.

PURCHASER'S NAME: _____

PURCHASER'S ADDRESS:
 ADDRESS _____ SUITE _____
 CITY _____ STATE _____ ZIP CODE _____
 HOME PHONE _____ OFFICE PHONE _____

CALIFORNIA ADDRESS (IF ANY):
 ADDRESS _____ SUITE _____
 CITY _____ STATE _____ ZIP CODE _____

 SIGNATURE DATE

Closing Comments



- Understand the specific requirements of your state, each state and local jurisdiction is different
- Be aware....states will hold retailers responsible for tax not collected from customers
- Exemptions must be supported by documentation, the larger the transaction-the more scrutiny....the bigger the cost if you do it wrong
- Understand the risks
 - Do it right.....sales tax continues to be your customer's cost
 - Do it wrong.....sales tax becomes your cost, with
 - Interest & penalties (which can add between 15% to 50% of the tax)
 - Increased cost of audit representation
 - Tremendous distraction to business operation

QUESTIONS?

**Thank you for the
opportunity to present.**



Contact Information



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PURCHASER'S NAME: _____

PURCHASER'S ADDRESS:

ADDRESS _____ SUITE _____

CITY _____ STATE _____ ZIP CODE _____

HOME PHONE _____ OFFICE PHONE _____

CALIFORNIA ADDRESS (IF ANY):

ADDRESS _____ SUITE _____

CITY _____ STATE _____ ZIP CODE _____

SIGNATURE

DATE