When our professionals provide multistate tax consulting services to a company, we approach the tax issue with a mindset that our efforts are designed to ensure that the company doesn’t pay any more tax than what is legally owed to a taxing jurisdiction. Lately, we are helping more and more clients to determine the best way to remit unpaid or underpaid sales taxes. This edition of Tax Advisor Weekly is an update of a previous article published at a point when the recession that began in 2008 began to substantially impact many state budgets.

Companies strive to be good corporate citizens by paying all sales and use taxes that are legally due, but sometimes companies make mistakes. Taxing jurisdictions will obviously continue to find new revenue by conducting sales and use tax compliance audits, and companies do not want to be saddled with an unanticipated liability that may significantly impact their bottom line. In addition, failure to file and/or pay sales and use taxes can result in a company paying substantial penalties and interest on top of the unpaid tax — potentially anywhere from 5 to 50 percent of the tax amount owed to the taxing jurisdiction.

Many states continue to experience significant budget deficits, which will likely continue into the future. These deficits may be a result of reduced sales tax collections due to less corporate spending, reduced property tax collections on lower property tax values, and smaller—than—expected state income tax collections due to corporate losses and/or increased business incentives to entice corporation development and expansion. In addition to conducting compliance audits on companies, states continually look for ways to increase collections or possibly offer incentives to come forward for companies that have inadvertently underpaid their taxes.

There continue to be many options available to remedy the unpaid tax situation if companies find they have substantial unpaid sales and use taxes. Each of the options described below has its advantages and disadvantages, and so taxpayers have to make a business decision as to which option is best for them based on their facts and their appetite for risk.

**Voluntary Disclosure Agreement**

If the amount of unpaid tax is substantial, a company may want to consider voluntarily disclosing the unpaid tax to the taxing authority. This is a great way to remit the unpaid taxes and potentially limit the amount of tax, penalty and interest that might be due. Most taxing authorities have a program in place that allows a taxpayer to voluntarily disclose unpaid taxes through a process known as a voluntary disclosure agreement, or VDA.

The requirements to qualify for a VDA vary by taxing authority. Some authorities require that the taxpayer not be previously registered for the tax in which it is requesting the VDA — but will likely require the taxpayer to become registered as a condition of granting the VDA. Others require that the taxpayer not have been previously contacted by the jurisdiction for audit or not be undergoing an audit for the tax involved. Additionally, most authorities reserve the right to void the VDA if the error is found to be as a result of fraud.

If the jurisdiction involved does not have an official VDA program or if the taxpayer does not meet the requirements, the state or local tax authority may be willing to work with the taxpayer to gain the tax revenue. Regardless of whether the VDA is requested through a formal VDA program or not, it is advised that the taxpayer remain anonymous until the VDA is approved and signed by the taxing authority.
A VDA provides several advantages for taxpayers. Most taxing jurisdictions will limit the look-back period to the same statute of limitations period that would be open under audit. However, taxing jurisdictions may not freeze the statute if the tax was collected from a third party on behalf of the jurisdiction but not remitted. Most taxing jurisdictions will waive penalties related to the tax in error, and some will forgive interest or a portion of the interest related to the outstanding tax liability.

Prior to executing a VDA, the taxpayer needs to be fully aware of all issues that could be discovered under audit for all taxes administered by the taxing jurisdiction. Therefore, it is important for companies to perform some sort of self-audit prior to executing the VDA. This will ensure there are no surprises and that the taxpayer can take full advantage of the VDA program.

**Tax Amnesty Program**

Generally, a tax amnesty program is offered by states for specific taxes and for a limited period of time. An amnesty program allows taxpayers to come forward to pay back taxes, with the state typically forgiving all or part of penalties or interest due. However, at the time of this writing, only Pennsylvania has an amnesty program in place (the amnesty period is scheduled to begin in spring 2017). With the legislative sessions for most states about to start back up, look for other states to implement some sort of tax amnesty program.

Most of the advantages of amnesty programs are similar to those of a VDA, as most states waive all penalties and limit the period to the current statute. In addition, many states will waive interest or a portion of the interest. The program is typically open to taxpayers who are already registered with the state for the taxes in question. Even if a company is currently under audit by the state, it may be possible to negotiate with a state regarding the amount of sales or use taxes being assessed in an ongoing audit, in addition to the state granting forgiveness of penalties on top of any tax due. It is important to note that some states may seek to impose additional penalties on companies not participating in the amnesty program who were found to owe additional taxes that would have been eligible for amnesty but not paid during the amnesty period — such as California did in 2004.

However, there are disadvantages to participating in a tax amnesty program. There are time constraints, since the state controls the timing of the amnesty period. Availability is also a concern, since the taxpayer does not control if or when a state will have an amnesty program or may not be aware of the problem until after the amnesty period closes.

The programs often come with specific restrictions or procedures, so it is important for a company to have a full understanding of the state procedures or limitations prior to coming forward to pay unpaid taxes under an amnesty program.

**Managed Audit Program**

A managed audit is a procedure that allows the taxpayer to report unpaid sales or use taxes by conducting a self-audit. The audit results are ultimately reviewed by the taxing jurisdiction. To qualify for a managed audit program, most tax authorities require that the taxpayer have the knowledge and resources to complete the audit in a timely fashion. Also, most authorities require that the taxpayer have complete records for the audit. They will take into account the taxpayer’s size, the complexity of its industry and the taxpayer’s filing and audit history before granting permission to a company to perform a managed audit.

There are several advantages to the managed audit program, including waiver of penalties. Some taxing jurisdictions will also waive interest or a portion of the interest related to the liability. A managed audit allows the taxpayer to control the audit, including the timing for conducting the self-audit, something that can keep the audit from dragging on for years. A managed audit also gives the taxpayer the opportunity to look for overpayments to offset the liability while conducting the audit.

The biggest drawbacks to participating in a managed audit program are the added workload and resource requirements. Additionally, as the taxpayer is entering into an agreement with the taxing authority to conduct the audit, the taxpayer has a responsibility to disclose any known issues. Since the taxpayer obviously has a better knowledge of its business than a taxing authority auditor would, the potential may exist that the taxpayer identifies a larger liability than if the tax authority conducted the audit.

Many jurisdictions have a formal process in place that allows a company to conduct a managed audit, but some states still have not initiated this type of audit program. You can always inquire as to whether the state would be willing to allow your company to perform the audit utilizing a managed audit approach.
One last point: as soon as you have received a notification of intent to audit, if you think that a managed audit approach might be relevant for your company’s situation, immediately contact the taxing jurisdiction auditor to discuss how you might qualify to utilize the taxing jurisdiction’s managed audit program, as there is typically a time limit for when you can request to participate in such a program.

**Self-Remittance Option**

Another potential option is to accrue and remit the tax related to the error on the taxpayer’s upcoming tax return, if it is already permitted for sales tax purposes. This method is the least intrusive option and requires much less time and staff resources. However, if a company chooses this method for reporting unpaid taxes, it should maintain detailed documentation relating to the remittance in the event of an audit.

A company can also amend the prior sales tax return to remit the taxes due. And by amending a return, this does not automatically generate an audit notification. However, be aware that if the amount is substantially more than previous filings, it could cause the taxing authority to take a closer look at the taxpayer’s account.

**Risking an Audit**

Of course, there is the option to do nothing and play the audit lottery. However, taxpayers who follow this path do so with some amount of risk. When choosing this option, the taxpayer should assess its risk of being selected for an audit. Tax authorities use many different methods for audit selection. Obviously, companies with substantial revenues have the highest risk of being audited. Tax authorities also target certain industries that have historically poor compliance records or that are affected by recent tax law changes. Audit leads are another method states use for selecting taxpayers for audits. Audit leads can be generated from audits of a company’s customers or vendors, or even from a person calling in a complaint to the tax authority.

Taxpayers with multiple lines of business are also more likely to be selected for audit, and those that are registered with a state for a different type of tax may have a higher risk. Several states have task forces focused on identifying companies that are registered for one tax but not another, and on identifying companies that advertise heavily in a state but are not registered to file tax. All of these issues need to be taken into account when determining the taxpayer’s risk related to waiting for the state to discover the error.

**Alvarez & Marsal Taxand Says:**

A company with unreported or underreported sales and use taxes has many options available. To determine which option is best, the company needs to determine its facts, quantify its liability and determine the period open for statute of limitations for each of its issues. The programs described above provide good opportunities to allow the informed taxpayer to save time and money, given that sales tax audits can require many hours of your time and take years to complete. Once these issues are addressed, the right business decision can be made about how to proceed to minimize the liabilities to the company.

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Related Issues:

Empowering the Sales & Use Tax Department [4]

The U.S. economy is constantly fluctuating, which makes for an ever–changing landscape in corporate America. For many companies, uncertainty in the economy can result in an array of changes such as downsizing, mergers, acquisitions and expansions. Keeping up with corporate changes and their impact on business operations can be a daunting task for the corporate sales and use tax department, especially since most tax departments are in a constant state of maintaining compliance and reactively defending the compliance during audits from various taxing jurisdictions.

Texas Ruling Lowers Physical Presence Standards Needed to Create Nexus [5]

While the Streamlined Sales Tax Governing Board continues its efforts to nullify the current Supreme Court jurisprudence that governs state sales tax nexus laws, the state of Texas has opted to lower the bar for physical presence by incorporating modern facts into the Quill v. North Dakota narrative. In a recent State Office of Administrative Hearings ruling, a Texas Comptroller of Public Accounts administrative law judge (ALJ) found that a Utah business (the Taxpayer) had substantial nexus with Texas because it licensed electronically delivered software and images to Texas customers.

What to Expect From Sales Tax Reform [6]

Over the last 15 years, e–commerce has become an increasingly important part of the U.S. economy.

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