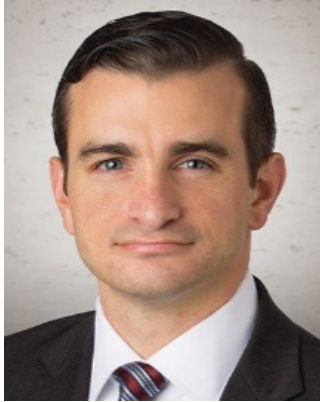


Innovative Audit Challenges: Mitigating Revenue Department Assessment Strategies

Thursday, May 7, 2020

Fredrikson
& BYRON, P.A.

Contact Info



Kyle Brehm
612.492.7515
kbrehm@fredlaw.com



Jennifer Pusch
612.492. 7210
jpusch@fredlaw.com

Agenda

- Accounting-Based Audits
- Third-Party Shipments
- Reporting Royalties
- Exemption Certificates
- Documentation
- Indirect Audits
- Miscellaneous

Polling Question 1

Accounting-Based Audits

- What is Going On?
 - Auditors are issuing assessments based on inter/intracompany journal entries, rather than on actual transactions. Auditors are requesting and trying to tie irreconcilable data sets (i.e., complete general ledger data, sales tax apportionment schedules, etc.).
- Who is At Risk?
 - Taxpayers using company-wide accounts to purchase and allocate spend. Taxpayers using accrual-based accounting methods, especially retailers. Multi-state taxpayers who provide too much data to auditors.

Accounting-Based Audits

- How Can I Mitigate the Risk?
 - Modify the way in which expenses are assigned to accounts and recorded to specific locations.
 - Avoid providing too much data to auditors.
 - Limit to state-relevant GL accounts
 - Eliminate journal entries if at all possible
 - Tie initial purchases, and the tax paid or accrued.
 - Prepare for the issue by creating and storing contemporaneous records on a monthly basis.

Polling Question 2

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Third-Party Shipments

- What is Going On?
 - Auditors are refusing to accept traditional documentation to evidence when transfer of title occurs.
- Who is At Risk?
 - Taxpayers acting as purchasing agents for exempt entities. Taxpayers making sales to parties using third-party shipping companies to export goods outside the Unites States.

Third-Party Shipments

- How Can I Mitigate the Risk?
 - Take time to map out the issue, including when title transfers, to the auditor.
 - Provide ample documentation to auditor, including purchasing agent agreements, bills of lading, or other relevant information.
 - Utilize the Department's chain of command and appeals options.

Reporting Royalties

- What is Going On?
 - In the franchisor/franchisee relationship, royalty receipts paid by franchisees are being attributed to services which are enumerated as taxable.
- Who is At Risk?
 - Taxpayers who either pay or receive royalty income in states that tax a variety of services.

Reporting Royalties

- How Can I Mitigate the Risk?
 - Carefully review franchisee/franchisor agreements to determine what is being provided in exchange for royalty payments.
 - To the extent taxable services are included, determine a consistent approach for accruing use tax on the portion of payments allocated to taxable services.
 - Consider using PLRs, Advisory Opinions, Managed Compliance Agreements

Polling Question 3

Exemption Certificates

- What is Going On?
 - Not a novel issue, just an annoying one. Auditors are increasingly focused on certificates as more taxpayers are deemed to have nexus.
- Who is At Risk?
 - Taxpayers with a large volume of exempt sale transactions. Specific risks associated with drop-ship transactions.

Exemption Certificates

- How Can I Mitigate the Risk?
 - Know the drop-ship rules, and other state-specific rules surrounding exemption certificates.
 - Regularly evaluate where you have nexus and therefore need to get certificates from exempt customers.
 - Utilize ECM technology to validate and maintain certificates.
 - Work with customers – Obtain certificates when requested within audit, determine how their audits were resolved.
 - Work with auditor on a sampling plan that makes sense.

Documentation

- What is Going On?
 - States are inundating taxpayers with documentation requests and often rejecting information that is provided when it is favorable to the taxpayer (i.e. software allocations, location-based exemptions, direct mail, bad debts).
- Who is At Risk?
 - Taxpayers who are allocating purchases such as software and direct mail. Taxpayers who are taking advantage of location-based incentives. Taxpayers who are pursuing bad debt refunds.

Documentation

- How Can I Mitigate the Risk?
 - Contemporaneous and consistent allocations are your friend.
 - Communicate with vendors to properly reflect ship-to locations on vendor invoices.
 - Utilize alternative documentation like purchase agreements, IP addresses, etc.
 - Work with state policy people if requirements are inconsistent with other SSUTA states.

Polling Question 4

Indirect Audits

- What is Going On?
 - Auditors are reconstructing sales using vendor or purchase invoices
 - Many assumptions made
 - Extrapolate one year over several
- Who is At Risk?
 - Restaurant and bar owners
 - Taxpayers without adequate books and records

Indirect Audits

- How Can I Mitigate the Risk?
 - Maintain adequate and complete books and records
 - Contemporaneous records
 - Account for spillage, free drinks, specials
 - Inventory service
 - Remote access to POS records

Miscellaneous

- What is Going On?
 - Auditors deeming all “gross sales” are taxable sales.
 - Auditors incorporating subsidiaries into the audit of a separate legal entity.
 - Auditors pulling data from outside the sample period into the examination.
- Who is At Risk?
 - Literally, all taxpayers.

Miscellaneous

- How Can I Mitigate the Risk?
 - Acknowledge that auditors don't have to be your adversary; try working with them to resolve these issues early.
 - Understand that auditor positions, and their information requests, are not always valid.
 - Utilize the options available to you:
 - Department chain-of-command
 - Taxpayer Rights Advocates
 - Department counsel and policy divisions
 - Administrative Appeals, Tax/District Court, Appellate Courts

Polling Question 5

Thank you!

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