Self-Assessment of Consumer Use Tax

Overlooking Consumer Use Tax could end up costing you in an audit. Are you prepared?
Introduction

For most companies, the imposition of sales tax is a normal part of business operations. However, consumer use tax is often overlooked, leading to costly transactional audit penalties and interest, or unnecessary overpayments. Consumer use tax associated with untaxed purchases often represents the greatest portion of a transactional audit assessment for many businesses. Consequently, allocating resources to ensure accurate consumer use tax reporting is not only advantageous in terms of trying to follow state and local use tax law, but it is also wise from a management and financial perspective as well.

Over time, most companies become fairly knowledgeable with respect to the taxability rules of their own products and services, and today’s fairly robust sales tax software technology increases the level of sales tax compliance even more. On the purchase side of a transaction, however, the same level of taxability knowledge may not exist. Purchase transactions that flow through an accounts payable system may not only be more complex from an implementation standpoint, but they are often given less priority by the relevant decision makers because they don’t directly impact customers or revenue. These “internal,” back-office transactions may not get the attention that is needed or they are sometimes ignored altogether.

Ironically, for businesses that do attempt to address consumer use tax reporting, the responsibility of deciding which purchase transactions are subject to use tax and which ones are not is often shouldered by the accounts payable department rather than by qualified tax professionals. This approach may make sense from a workflow perspective, but it is problematic because accounts payable personnel are usually not tax experts; consequently, the risk of either under or over self-assessing consumer use tax is high.

Because a manual process is both labor-intensive and error-prone, an automated consumer use tax reporting system is actually more cost-effective than it may initially appear. This whitepaper examines self-assessment and reporting of consumer use tax and offers practical solutions for economically automating the process.

Defining Consumer Use Tax

Generally speaking, when a buyer and seller are located in the same state in terms of ship-to and ship-from locations, a sales tax transaction takes place. The seller has the legal obligation to collect the sales tax due if the product or service is subject to tax, unless valid exemption certificate documentation has been provided in lieu of paying the tax.

In the event that a buyer and seller are located in different states — or in some cases in different localities in the same state — and delivery of the product takes place in the buyer’s state (or locality within the same state), the transaction is generally viewed as a use tax transaction, in full or in part. The seller may or may not have a legal obligation to collect the use tax due, depending on their presence in the ship-to state and/or locality.

If the seller has sufficient nexus as determined by individual state and local statutes, they are required to register and collect any seller’s (also identified as vendor’s or retailer’s) use tax that is applicable on the transaction, providing no exemption certificate documentation had been provided to the seller in lieu of paying the tax. However, the buyer may be responsible for self-assessing, reporting and remitting consumer use tax if:

- The seller has no legal obligation to collect the use tax.
- The seller is not authorized to voluntarily collect use tax as a convenience to their customers in non-nexus states and/or localities.
- The seller has sufficient nexus but fails to meet their obligation to collect the sales or use tax for any reason.
- The seller was legally released from the obligation of collecting the tax due when the buyer provided valid exemption documentation in lieu of paying the tax.
The Buyer’s Obligation

When a seller has not included tax on their invoice or other billing statement it is generally because of one of three reasons:

- They have determined that the transaction is non-taxable based on state and local statute.
- Exemption certificate documentation has been provided in lieu of paying the tax.
- The seller is not authorized to collect the tax that is presumably due on the transaction.

Regardless of the reason, the buyer may have an obligation to self-assess the use tax and remit it directly to the state and/or local tax authority based on whether or not the product or service is subject to tax.

However, self-assessment is often a labor-intensive process, and instead of delegating this task to qualified tax professionals, some companies rely on accounts payable personnel to make taxability decisions related to untaxed purchases. Unfortunately, this approach runs the risk of under self-assessing, resulting in penalties and interest during an audit, or over self-assessing, which can cost a company a great deal of money that is unlikely to be discovered and recovered before the statute of limitations runs out. To lower the risk of penalties and interest, or potential overpayment, an automated consumer use tax system can be valuable.

Consumer Use Tax Automation — Review, Calculation and Accrual

Automating the self-assessment of consumer use tax can be a difficult task from a systemic standpoint because of implementation complexities as well as the disjointed nature of extracting accounts payable or other purchasing data and then running it through a tax engine for use tax consideration. In theory, any purchase transactions where sales or use tax was not calculated and imposed by the seller should be viewed as a candidate for consumer use tax review. In order for a system to be viewed as a viable consumer use tax solution, it should be able to address all the what’s, how’s and when’s that are required for the self-assessment of consumer use tax.
At a minimum, a consumer use tax system should be capable of accomplishing the following tasks:

- Ascertain whether consumer use tax is due on a purchase transaction based on predetermined taxability rules built into the logic of the system.
- Determine if the sales or use tax due was included on an invoice and paid to the vendor.
- Generate the needed use tax calculation based on an accurate use tax rate.
- Handle use tax accruals for all untaxed purchase transactions that are determined to be subject to consumer use tax in one of the following ways:
  - Generate the use tax accruals
  - Feed the needed use tax information to an Accounts Payable or GL system for use tax accrual generation
  - Generate a report identifying the required use tax accruals

Depending on the needs of a company, the accounts payable and/or purchasing system capabilities, and management’s tolerance to under- or over-payment risk, a consumer use tax solution may need to be able to perform one or both of the following additional tasks:

- Determine if the seller imposed tax correctly by comparing all taxed purchase transactions to taxability rules. The system then needs to generate an electronic feed or hardcopy report for short payment, credit or refund request purposes.
- Determine if the seller charged the correct tax rates by comparing all taxed purchase transactions to system and custom tax rate tables. If the tax was under-charged, the system needs to generate the use tax accrual to cover the difference, or if the vendor over-charged based on an erroneous tax rate or sourcing rule the system needs to generate an electronic feed and/or hardcopy report for short payment, credit or refund request purposes.

A full-featured use tax system should facilitate the use tax review, calculation and accrual generation either in real-time or through periodic batch processing — daily, weekly, monthly or quarterly. Additional selection or filtering functionality may be required to help the user “slice and dice” transactional data to limit the consumer use tax review to a predetermined list of GL account numbers, specific vendors or other criteria.
In most cases, in order to obtain complete consumer use tax functionality, the user’s Accounts Payable system needs to have a separate field for the sales tax charged on the invoice by the seller so the system can differentiate between transactions that were taxed by the seller and those that were not.

**Consumer Use Tax Returns**

After the consumer use tax review has been performed, all the required calculations are complete, and use tax accruals have been generated, an electronic file will need to be fed into an automated tax return processing system for consumer use tax reporting. If an automated tax return processing system is not being utilized, then a hardcopy report will be needed for review and tax return preparation. Consumer use tax is reported either on a specific line or lines on a sales/use tax return or in a separate consumer use tax return. Either way, all consumer use tax data should be labeled in such a way to ensure that it can be populated in the correct area of the return.

**Putting It All Together — An Automated Approach, From Beginning to End**

Self-assessing consumer use tax is a challenge, and when performed manually — without the use of consumer use tax software — it is a very labor intensive process. The best approach to self-assessing consumer use tax is to automate the process as much as possible using a robust consumer use tax software system. With software specifically designed for consumer use tax, companies can greatly minimize or even eliminate self-assessment risks by automating the process based on the judgment and interpretation of highly qualified tax professionals.

**Consumer Use Tax Solutions from CCH**

Reduce the time you spend monitoring and updating tax rate and taxability rules. **CorpSystem Sales Tax Office** is a server-based tax calculation engine that will handle your most complex sales and use tax requirements. Sales Tax Office combines industry-leading tax rate and taxability content from CCH with highly accurate jurisdiction boundary information and sophisticated logic. The system supports the self assessment of consumer use tax on taxable purchases where tax wasn’t collected by the supplier.

**CorpSystem Sales Tax Returns Online** helps you save time and eliminate errors by automatically populating your sales and use tax forms, schedules and worksheets with tax information from your ERP system or from Sales Tax Office. Review, edit, print, audit and even e-file the signature-ready returns, and download Detail Filing Reports to streamline your check request process.
When you work with CCH, a Wolters Kluwer business, you can count on a variety of exceptional support options, including:

**A Team of Experts** — Professionally trained in all areas of tax and technical support, just a toll-free call away at 1-866-513-CORP (1-866-513-2677).

**CorpSystem.com** — Instant online access to product and training information, support and program updates.

**Regional Support Team** — Ensures your smooth transition to the CorpSystem suite of products and assists with any training needs.

**Effective Training Options** — From in-office sessions to Web conferencing.

For more information about the CorpSystem suite of sales tax, income tax and workflow solutions call **1-866-513-CORP (1-866-513-2677)** or visit **CorpSystem.com**.