
AGA

California Sales and Use Tax Training

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Presented by:

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Introduction

- **Jacob Bholat –Partner**
 - 14 years in consulting experience in Government, Big 4 and Recovery Consulting
 - Primarily focused on Not for Profit, Healthcare and Government clients
 - Former State auditor with Board of Equalization
- **The purpose of this discussion:**
 - Overview of Sales Tax
 - Discuss approach/philosophy to improve sales and use tax compliance
 - Add to your knowledge to increase awareness of areas of greatest concern and provide information on common tax issues

Overview of Topics

- Overview of sales and use tax
- Areas of sales and use tax audit adjustments and steps for improvement
- Resource material – Taxability of Common Purchases
- Tax Decision Chart

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General Overview - Sales & Use Tax

- Excise tax
- Applies to tangible personal property (TPP)
- Transaction based
 - Sale – revenues generated by sales of TPP
 - Consumption – purchases of TPP used for operations
- Presumption – all sales of TPP are subject to tax unless specifically exempted (GUILTY until proven *innocent*)



Sales and Use Tax Compliance Challenges

- **Taxes Administration**
 - Decentralized tax decisions (AP processors)
 - No true stakeholder: Procurement, AP and Accounting
 - Vendor Compliance – Registration not required for all vendors, multiple states involved
 - Vendor conservatism
 - Sales v. use tax reporting obligations
- **Transactional**
 - Volume
 - Non-standardized information or disclosure
 - Product complexity (medical, IT, Services, etc.)
 - Product visibility (What is product 123 on vendor invoice?)
 - Diversity of department, activities and usage
- **System Limitations**
 - Sales and use tax visibility
 - PO/Invoice tax matching
 - Minimal review after transactions processed

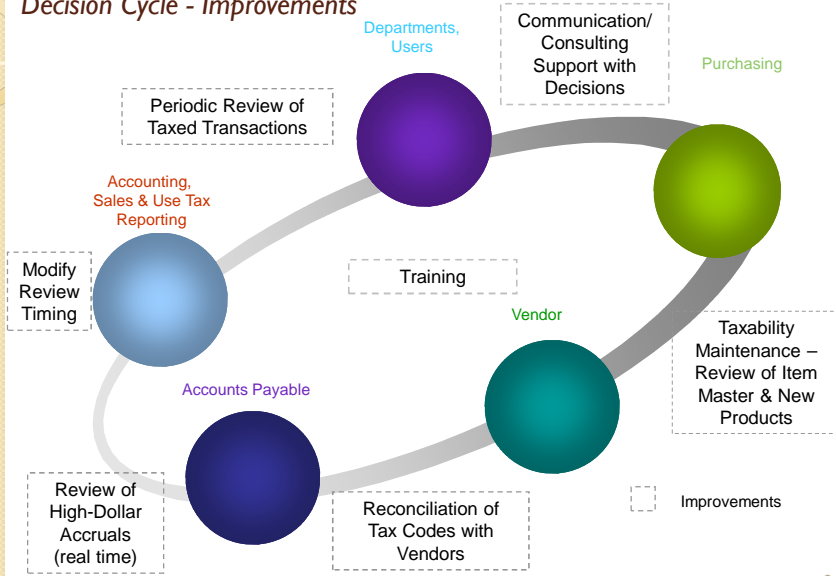
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Compliance Improvement Options

- **Potential Process Improvement Actions**
 - Training & reference materials for AP and Purchasing
 - Product taxability catalogues (item master)
 - Establish additional review procedures and controls
 - Perform recovery work to identify issues
 - Reconciliation of client and vendor tax codes (High volume vendors)
 - Review taxability set-up for new and catalogue products
 - Tax decision support

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*Sales & Use Tax Compliance Factors
Decision Cycle - Improvements*



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Preparing for a Sales Tax Audit

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Revenue Sources

- Governments primarily provide services to citizens, which are exempt from sales tax
- Often there are ancillary operations that result in sales of TPP
- Concessionaire operating on your property
 - Do you know for certain that all businesses that operate on your premises are registered?
 - If not, you could be held liability for sales tax.
 - Party/entity that operates/sells and collects revenue should be the party that reports tax.
 - Confirm vendor is registered
 - Contract, certificates and tax information should be maintained at all times

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Revenue Sources

- Miscellaneous sales – Are you reporting tax on all the items you sell to customers/residents/employees?
 - Departments should track miscellaneous revenue and ensure taxable charges are properly reported
 - Vending sales
 - Reports and other types of information provided in tangible form
 - Supplies sold to residents or other consumers
 - Sales of assets for disposal

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Use Tax Liability

- Use tax assessment
 - Single largest assessment area for the Board of Equalization
 - Ensure documentation availability (contracts, invoice etc) for audit analysis and review
 - Provide detail of item description when requesting purchases and processing PO's
 - Try to input tax separately in system when processing invoice

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Over Payments of Tax

- Use Tax Accruals - Tax reported on exempt transaction on your sales tax returns
- Vendor Errors – Vendor's charge and collect tax on the invoice for exempt items
- Governments are generally very fiscally conservative so they tend to pay tax “when in doubt”
 - Funding sources are limited, so future liability creates budget issues

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Common Refund Areas

- Areas with significant opportunity
 - Medical products
 - Software and Software Maintenance
 - Services and Construction Contracts
 - Voter and Sample Ballots (significant planning can be done to exempt portion)

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RESOURCE MATERIALS

Application of Tax

Specific Areas

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Labor Charges

- Professional fees and Services unrelated to the sale of TPP are exempt
 - Consulting, legal, research, etc.
- Services related to the sale of TPP
 - **Exempt**
 - **Repair** – charges for restoring tangible personal property to its original condition
 - **Installation** – charges for labor or services used in installing or applying the property sold
 - Does not have to be separately stated
 - **Taxable**
 - **Fabrication** – labor which changes the identity of the tangible personal property from one form to another
 - **Assembly** – assembly charges for new products

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Computer Software

- Software (canned) - purchases of canned software including charges for license fees, site licensing, upgrades and other end user fees
 - **TPP delivered – taxable**
 - **Delivered via Load-N-Leave – exempt**
 - **Delivered via telecommunication lines/downloads – exempt**
- Software (custom) – Custom made to customer order
 - Have taxability reviewed if uncertain

TAXABILITY OF NORTEL CASE
MAY CHANGE TO EXEMPT

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Maintenance Contracts

- Hardware maintenance
 - Mandatory – taxable
 - Optional – exempt
- Software maintenance - Canned Software (off the shelf)
 - Mandatory – follows taxability of software
 - Optional
 - With tangible property - 50% exempt
 - Without tangible property – exempt
- Software maintenance – Custom Software (more than 50% of charges are for custom programming)
 - Mandatory – exempt
 - Optional - exempt

TAXABILITY OF NORTEL CASE
MAY CHANGE TO EXEMPT

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Leases

- Leases (defined as “continuing sale or purchase”)
 - Rental, hire or license for tangible property
 - Temporary use of property
 - No bargain purchase option
 - Nominal buyout option – Lesser of one percent or \$100
 - (If nominal option, contract will be treated as an outright sale)
- Application of Tax
 - Default: Tax due on rental payments
 - Election: Lessor may elect to pay tax on its purchase price of the leased property in the first reporting period. Thereafter, no tax is due on rental payments.

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Leases (continued)

- Election Specifics
 - Irrevocable
 - Must occur in first reporting period after placing the property in rental inventory
- Compliance issues
 - State Board of Equalization audit policy looks to the Lessor for compliance
 - Lessee has limited visibility to payment of tax on original purchase by Lessor (per invoices)
- Exclusions:
 - Use of property less than 24 hours & \$20 with restricted use; linens with laundry services; motion picture films or video tapes; household furnishing with living quarters; mobile transportation equipment (Lessor owes tax on its use); and
- Tax-paid property in substantially the same form.

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Construction Contracts

- All contractors have a presence in CA and are obligated to properly administer the tax
 - **ERS's experience shows that most use tax accruals for construction contracts result in overpayments**
- Contractor provides materials, fixtures and occasionally equipment under their contracts, generally:
 - Tax due on contractors cost of materials and fixtures, unless tax is billed on their invoice
 - Contractors are retailers of equipment
- Contractors may or may not charge tax on invoice
 - As consumers, contractors generally pay tax on their purchase of materials and fixtures installed and do not bill sales or use tax.
 - As retailers, contractors generally will collect tax on equipment sales
 - KEY: Separately stated materials are not taxable sales

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Transportation

- Actual shipping charges by common carrier are exempt
- Shipping provided by retailers facilities are includeable in the taxable selling price (if exempt sale, no tax on related shipping)
- Shipping and handling
 - Many vendors charge shipping and handling
 - Only the actual shipping costs by common carrier are excludable*
 - Handling charges are includeable in the measure of tax

* Determining the actual shipping cost may be difficult and time consuming. An alternative is to use an estimated shipping and handling percentage to determine a taxable handling amount.

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Other Exemptions

- Subscriptions – publications issued more than 4 times and less than 60 times a year are exempt
- Purchases from the U.S. Government and its instrumentalities are exempt
- Research and development contracts

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Thank You!

This seminar is intended to provide guidance for you. The seminar materials are limited to the California sales and use tax treatment of your sale and purchase transactions and may not apply to other industries or states.

The seminar materials are based upon the applicable law, regulations, and other tax authorities in effect as of the date of this presentation. You should research the actual taxability of each transaction before making a final decision.

We will update these materials upon your request.

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