



LGT

FINANCIAL FOCUS



Lane Gorman Trubitt, L.L.P.
Accountants & Advisors

Accountants & Advisors for a New Economy

Saving Tax Dollars - With a Reverse Audit

If you haven't paid enough sales and use tax, odds are you'll hear about it. Unfortunately, when you overpay, the IRS isn't as quick to notify you. In an attempt to identify overpayments and seek reimbursements more and more companies have begun using reverse audits.

Take Advantage of Tax Exemptions

The majority of overpayments come from unclaimed tax exemptions. For Example, manufactures are exempt from the sales tax on their equipment used in manufacturing or recycling. With the sales tax in Texas over 8% it can be well worth your time to ensure you are receiving all the exemptions you are entitled. Still other exemptions may be available for the chemicals and utilities you use as well as the computers, software, and peripherals employed in research and development.

In order to combat overpayment, many companies have sales and use tax compliance systems in place, but such systems need to be reviewed every few years to ensure that they are still functioning properly. Business expansion or downsizing, employee turnover, or even just honest mistakes can all compromise the safeguards you have in place, resulting in you paying more in sales and use tax than you should.

Timing is Everything

One of the best times for conducting a reverse sales and use tax audit is when you've begun a major capital project. Even if you can't justify the time and expense of a full companywide audit, you can still audit the transactions specifically associated with this project. This will help to uncover overpayments during the process.

Another excellent time for a reverse audit is when there is a significant change to state tax law. Oftentimes state tax law changes are overlooked since sales and use tax exemptions typically don't apply to local taxes. If your state has recently revamped its tax laws a reverse audit can be used to identify any missed opportunities under the new law.

The Anatomy of a Reverse Audit

A reverse audit should look at both your tax compliance systems as well as your purchasing records. It should encompass your entire business and go back as far as the statute of limitations governing state tax reviews will allow.

Payments that should be reviewed include:

- Warehouse equipment
- Safety equipment
- Maintenance fees
- Service transactions
- Software licenses
- Protective clothing

When examining whether you have made overpayments in these or other areas it's important to have a comprehensive understanding of your operations. Companies must be able to examine the process as a whole in order to maximize the benefit from potential tax exemptions.

Forecasting Overpayment

Current database software is now available that can help identify where overpayment is most likely to occur by reviewing random samples of invoices and then using those results to estimate total overpayments. This can be an acceptable method of projecting overpayments in many states; however, others may require a complete and detailed review of each individual purchase. Before beginning the process you will want to understand the sampling requirements and tax exemptions for your state.

Worth the Investment

Reverse audits can be a lengthy and involved process, but the rewards can make it well worth the effort. When utilized to its full potential a reverse audit will not only allow you to claim tax refund rewards that had once been lost to you, but update and finalize your compliance systems to minimize overpayments in the future.

The intricacies of sales and use tax law are complicated. Before tackling them on your own, be sure to work with your trusted State and Local Tax specialists at LGT. Pat McCown, SALT Partner, can be reached at (214) 461-1416 or by email at pmccown@lgt-cpa.com and Jo Chadwick, SALT Principal, can be reached at (214) 461-1477 or by email at jchadwick@lgt-cpa.com.