

Sales Tax Has a Major Impact on Many Businesses

By Brent Watson, CPA

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Twenty-three years ago, my supervisor at a Fortune 500 manufacturer asked me what I knew about sales tax, and I replied, “It’s at the bottom of my Walmart receipts.”

Most accountants are probably in the same category I found myself in when it comes to sales tax. However, sales tax has a vital impact on many businesses: Proper handling of it can produce significant savings, while improper handling can result in business failures. Additionally, Financial Accounting Standards 5 requires financial statements disclose loss contingencies when “(a)... it is probable that ...a liability had been incurred at the date of the financial statements, and (b) the amount of loss can be reasonably estimated.” For accountants on the tax side of the ledger, clients or supervisors often look to you as their tax advisor, assuming you will advise them on all significant tax matters. This article provides an overview of the most important issues accountants should be aware of regarding sales taxes.

Major Exposures:

- **Retailers and Wholesalers** – Retailers and wholesalers can suffer great audit assessments because of failure to collect and maintain exemption certificates. If a sale of tangible personal property is made and no sales tax is charged, the retailer should be sure to obtain and maintain a valid exemption certificate from the customer. Auditors usually make this their immediate focus—and assess tax if the certificates are not provided.

Unfortunately, Oklahoma has many specialized exemption certificates to deal with, including special agricultural exemption cards, the MSEP (manufacturer’s certificate), letters to churches and exempt non-profits, tribal exemptions, and even disabled veteran’s exemption cards. For resale and most other exemptions, Oklahoma does not provide an exemption certificate form, but the requirements to document the exemption are specified in Oklahoma Administrative Code 710:65-7-12:

- A copy of the purchaser's sales tax permit or, if unavailable, the purchaser's name, address, sales tax permit number and expiration date;
 - A statement that articles purchased are purchased for resale; and
 - A signature of the purchaser or a person authorized to legally bind the purchaser.
- **Multi-State Vendors** – Multi-state vendors often assume that they are not required to collect tax outside of their home state. While this is often true when a business begins making remote sales, when a seller begins to deliver in their own vehicles, make regular sales calls in a state, or has employees or agents working in states to make repairs, installations, etc., a seller may wake up to find that they have nexus in additional states.

At that point, it’s crucial that the seller registers in the states in which they have nexus and establishes a method to charge and remit taxes correctly as well as to collect and maintain exemption certificates. If the number of sales transactions is high enough and the sales destinations are spread over a variety of localities in multiple states, the seller may need to consider installation of sales tax software. Such software has become much more affordable and it readily integrates with many accounting packages. Additionally, some software providers provide turn-key compliance services, including filing and payment of returns.

If the proposed Main Street Fairness Act or some similar law were to be enacted, the popular notion of nexus will be effectively eliminated, and many more interstate sellers will be required to collect and report sales taxes in many states. This could present a costly burden to many retailers.

- **Contractors** - Contractors face special problems because of the nature of their business. Because they transform personal property into real property, they are normally seen as the consumer of that property, and by default, owe sales taxes on their purchases of materials. However, Oklahoma law includes many special provisions for specific types of exempt customers that, in some cases, allow the contractor to utilize the customer’s exempt status to pass through to the

contractor for materials, and in a few cases (agricultural permit holders, college and rural electricians), even consumable materials used in the project.

Generally, OAC 710:65-7-13(c) requires that the contractor document the exemption by obtaining a copy of the exemption letter or card issued to one of the exempt entities with which the contractor has contracted and documentation indicating the contractual relationship between the contractor and the entity. Contractors should be aware that specific exemptions apply to specific types of exempt customers. Sales to contractors who are working for the federal government are not generally exempt, unless the government is the purchaser of the supplies, possibly by appointing the contractor as their purchasing agent.

- Purchases Subject to Use Tax - Purchases made out of state often do not contain charges for sales tax because the seller is not registered in Oklahoma. Many such purchases are made using corporate purchasing cards (P-cards). This exposure can affect all businesses, professional-type businesses in particular, like various medical or veterinary providers or oil and gas companies purchasing pipe from out-of-state suppliers, which both generally purchase expensive equipment from remote sellers.

Major Saving Opportunities:

- Manufacturers – Oklahoma provides one of the very best and broadest sales tax exemptions in the nation for manufacturers. The exemption applies to “goods, wares, merchandise, tangible personal property, machinery and equipment sold to a manufacturer for use in a manufacturing operation.” (OAC 710:65-13-150.1 and Okla. Stat. 68 §1359[1]) The exemption applies to materials used beginning with the place where materials enter a manufacturing site and ends with the place where materials leave the manufacturing site. It applies to items that are taxable in most other states, including warehouse racks, yard tractors, prototypes, inventory tracking materials and machinery, energy used in the manufacturing process, maintenance tools, employees’ safety apparel and consumable materials.

Manufacturer’s should get an “MSEP” (manufacturer’s sales tax exemption permit) from the Oklahoma Tax Commission and utilize it to make these purchases on an exempt basis. MSEPs expire after three years.

- Resellers – Often, sellers pay tax in error on items they resell or lease. This can apply in cases such as the following:
 - Lessors who purchase items that they ultimately lease to others. The lessor should collect sales tax on the leases;
 - Auto retailers who purchase auto parts to apply to vehicles that require repair before sale; or
 - Purchases of materials that are resold with other items, such as containers for meals at restaurants, etc. For example, Okla. Stat. 68 §1357(11) provides an exemption for: “Sales of one–use utensils, paper napkins, paper cups, disposable hot containers and other carry–out materials to a vendor of meals or beverages.”

Sales taxes can have a major impact on businesses. By knowing the critical common issues, you can help your business or your clients’ businesses maximize savings and avoid exposure issues that could potentially bankrupt a business. Clients often believe their accountants are advising them on all tax-related matters, whether or not such services are contemplated in engagement letters. Therefore, it behooves CPAs to advise their clients to make sure their sales tax matters are in order before an audit assessment delivers a heavy blow.