Sales and Use Tax System | White Paper

The Hidden Costs of Your Manual Sales and Use Tax System

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What you don't know can't hurt you, right?

If something is hidden, it's out of sight, and many times, out of mind. Sales and use tax compliance presents risks and costs, of the apparent and the hidden variety, for businesses of all sizes. However, sales and use tax compliance is rarely first on a business' radar when the discussion turns to reducing risks and costs.

Unfortunately, it sometimes takes a bad experience, like an audit or even a string of notices, to remind business owners of the critical importance of accurate sales and use tax calculation, collection and remittance. From the specialized tax research necessary to maintain rates and taxability, to shifting jurisdictional boundaries, to evolving payment and filing requirements or even to resale certificate management, the apparent costs of sales and use tax compliance are easy to spot. Unfortunately for business owners, many other costs and inefficiencies of sales and use tax compliance are hidden. Hidden costs and hidden sources of risk are often magnified in a manual system.

Hidden costs associated with a manual sales tax management process are not always obvious when assessing the costs listed above. Instead, hidden costs stealthily sap efficiency, waste resources and occasionally even create risk where none existed. The identification of hidden costs provides an opportunity to improve processes and streamline business function to reduce overall costs as well as reduce risks in the sales tax arena.

Here are five areas where hidden costs can wreak havoc on your business overhead and bottom line:

- Logistics
- Personnel management
- Reporting and analysis
- Audits
- Credit tracking

Hidden Cost #1: Logistics

Logistics of managing sales tax compliance include processing mail, maintaining copies of invoices, receipts, forms, notices and retention of government updates, bulletins or rate changes. Of course, the storage of these items and the ability to access them adds to a business' already formidable paper management efforts.

Notices: Processing mail can cause problems if mail is misdirected, returned or just plain missed. Often in a manual system, notice management is a single person's responsibility. The time sensitive nature of notices and the cascading effect of notice mis-management, make this area especially likely to increase risk of assessments and increase cost in penalties and interest. If a notice is received and that person is on vacation, no one is available to handle the concern and respond quickly to the request for information or clarification from the state. Delayed responses can place you at risk of being selected for an audit and can expose you to possible penalties and fees for not resolving the notice.

The state can restrict your business activities and even halt business until the notice is resolved. One company didn't realize they had received a notice at their Texas location. The notice languished on someone's desk unheeded. The company found out when the state notified them that their ability to do business had been shut down in that state. It was a scramble of extra time and cost in penalties to bring the business back into active status in the state.

Records Retention: In a manually managed sales tax system, most businesses maintain hard copies, as well as electronic copies of sales tax returns. Reducing manually managed hard copies of returns decreases the demand on your overhead costs of paper, staples, files, file folders and even copier maintenance.

Many companies must rent a storage facility because they do not have adequate space to store all their records at a main location, or if they do, it is an extra cost for the additional space required just for storage of records. One company didn't have to send their records to an outside storage facility, but instead, stored their records on shelves and up in the eaves of their warehouse. They exposed their records to rats and other varmints that chewed through the boxes and damaged records. When searching for a specific time period, they many times opened the box labeled for that year or quarter but didn't find the specific records needed and had to search through other boxes for hours. The danger of climbing up ladders to reach the stored boxes up in the eaves was a safety issue for employees and opened the company to potential lawsuits.

Other costs associated with maintaining a manual system include the costs of labeling, filing cabinets and boxes. Add up these costs and you can see how streamlining a manual system with digital copies and storage reduces overhead expenses.

Hidden Cost #2: Personnel Management

Even though one person may be dedicated to tax issues within the company, businesses often employ additional, temporary staff to assist with sales and use tax compliance, even if only for a few days a month. This situation means non-tax professionals are handling sales and use tax compliance, and perhaps more important: the hours add up and present opportunity costs of their own as staff time is diverted from other income-producing activities. Whether these employees are temporary, part-time or full-time, your company must manage the costs of sick leave, payroll and benefits. These additional concerns expose your human resources department or company to added costs and management duties.

For your human resources concerns, it's more than just payroll: it's also missed deadlines, stress, inefficiencies and loss of time and money in the office. You must plan around vacations for your knowledgeable staff and bear the expense to cross-train professionals who don't specialize in tax. This has added up to a fair amount of fluidity and attrition in the sales tax field. The time and expense for training that must be repeated with each new employee plus a high attrition rate impacts your bottom line and relationships with the states and your customers.

Hidden Cost #3: Reporting and Analysis

Picture your accountant coming to you and asking for clear data and information about the amounts for sales tax for the first six months of the year. Could you show him what you collected? Would you be able to easily produce the records and information, or would you need to calculate it and look in several locations to show him what the activity resulted in for sales tax? Would it take several employees to gather the data?

Let's now place you in front of an auditor who is questioning the figures on your sales tax returns for the prior three years—could you produce the data without making him wait a couple of days? Could you quickly show him that your process allows for clear traceability? Can you show the logic behind the sales tax returns? And while the auditor is there, a dedicated staff member who is knowledgeable in your sales and use tax process needs to be made available—taking their valuable time away from other business needs.

Filing: The time to gather your reports in order to file your sales tax returns is an added hidden cost within a manual system. Activities and items that add to your hidden costs include: copies, files, staff time and other tasks being left undone in order to handle sales tax demands. In addition to this, each filing needs to be consistent with prior filings and with industry standards or you open yourself to greater audit exposure.

Whether you file monthly, quarterly or yearly, reviewing a previous year of sales tax activity and striving to figure out how to apply consistency to how you present the information in relation to the previous year's return is an added expense that takes valuable employees away from other duties.

Hidden Cost #4: Audits

Most financial applications or Enterprise Resource Planning do not capture full audit details. This information is critical when faced with an audit. If an auditor finds something missing, then that is justification to dig deeper and evaluate other information—sometimes even your customer's information! Having a clear audit trail with complete information reduces your audit risk, improves audit results and can even increase customer satisfaction in your business.

Manual sales tax management opens the business to inaccuracies in setup and maintenance of customers, tax rules and rates along with incomplete audit records. This creates a burden on internal and external resources, extra costs for legal support, penalties and fees, charge-backs and reimbursements as well as loss of productivity. Incomplete tax-exempt transaction trails have been known to increase the cost of an audit by multiples and deepen the scrutiny of a business.

One business noted that failing to collect or find an exemption certificate for a tax-exempt transaction where the sales tax would only have been $80 on the transaction, has been known to cost their company up to $20,000 in an audit. Why? Because once a sampling of transactions shows missing or incomplete exemption certificates, which means invalid certificates, an auditor will take the sampling and calculate the average percentage of assumed invalid certificates and make an assessment with penalties and fees based on that calculation.

If an auditor sees you don't have all your information readily available, he may require additional information or consider it as evidence that you don't have a process that works. In order to capture potential mistakes, he will scrutinize further, thus increasing your risk of negative audit findings and expense due to further analysis and time required for the audit.

Showing you are able to produce a consistent process with confidence and regularity helps to create a better relationship with the auditor, even if the process is not correct—consistency goes a long way. Consistency is difficult to manage in a manual sales tax process.

Hidden Cost #5: Credit Tracking

Some known costs are credit memos or charge-backs to a customer who has been improperly charged sales tax when they are sales tax-exempt. Having to return the sales tax through a credit memo or cutting a check and mailing it to the customer, increases staff time and resource expense. The damage and hidden cost in that transaction is a loss of good customer relationship if it happens too often. But there are other hidden costs with credit tracking.

If your company has filed a sales tax return and remitted the sales tax you just credited back to the customer, you will need to recoup that cost by requesting that the state returns that tax—so you must create an amended return, file and wait for the return of the tax. Sometimes this money is just forgotten or left with the state and becomes money lost due to not having enough time to file an amended return or calculate the corrections.

Alleviating the Hidden Costs of Manual Sales Tax Management

Merely creating a process may not adequately reduce the hidden costs associated with manual sales tax management. However, it is a good beginning. Reviewing your processes and designing a process workflow that reduces redundancy, unnecessary activities and improves clarity and consistency is certainly a step in the right direction.

Once you've documented your current business sales tax process as it exists, you should then design the ideal workflow to minimize demands on staff and increase accuracy. Automation of certain sales tax management activities helps businesses to reduce the strain on staff time and knowledge as well as increasing accuracy.

Tasks that can be automated or outsourced to a company that specializes in sales tax compliance include:

- Sales tax calculations and research;
- Exemption certificate collection and management;
- Sales tax return preparation, filing and remittance of liability; and
- Reporting.

Tasks that can be automated or outsourced

Sales tax calculations and research

Outsourcing and automating your sales tax calculations to a sales tax expert company removes the time required of staff to learn new rules and regulations and apply them in your financial applications and tax decision engine. A sales tax calculation engine that provides up-to-date rules and regulations including product taxability relieves hidden costs associated with staff research time, documenting changes, implementing changes and proving evidence to auditors and accounting staff that the correct calculation was applied.

A Software-as-a-Service model provides added savings through scalable transaction-based costs. Having a solution that integrates your tax decision engine, e-commerce store, Point-of-Sale (POS) and financial application makes the process and workflow even more seamless, reducing any duplication and redundancy in your process by sharing information across platforms.

Exemption certificate collection and management

Exemption certificates are an area where documentation management can become cost-prohibitive and labor intensive without an automated or outsourced solution. Manual management of exemption certificates is an area that causes huge audit risk when certificates are not easily produced, traced and associated to transactions clearly. Tracking expirations and accuracy of certificates can exponentially increase the time and cost to manage this important part of non-taxed transaction compliance. An automated solution that integrates with your existing financial application supports a consistent process to enable you to make collection, expiration tracking and application to transactions easy and cost effective.

Sales tax returns

Sales tax returns are a necessary burden of sales tax compliance. Automating and outsourcing this process can generally relieve up to two weeks of staff time per month for many companies. But in addition to that, if notice management is included in the sales tax return service, you are guaranteed prompt responses to queries from states and sometimes shared liability.

The steps to alleviating the expense and challenges within a manual system include:

- *Improving processes to use a consistent, defined workflow;*

- *Increasing sales tax calculation accuracy;*

- *Reducing paper waste, copies, hard copy retention;*

- *Implementing a system that provides automation that integrates with your financial application.*

Reporting

Reporting enables your business to clearly see, at a glance, transactions, sales tax and even sales tax exempt information depending on the service you are using to produce your reports. In a manual system, reports can be laborious, inaccurate and difficult to manage—especially if your business has a high transaction volume. Automating a reporting process that is able to pull the transaction and sales tax information and organize it in a way that is useful can be invaluable to business productivity and cost effectiveness.

Benefits of using a Software-as-a-Service (SaaS) to deliver sales tax compliance

Selecting a SaaS-based model to deliver your sales tax compliance processes including research, calculation, exemption certificate management, reporting and returns preparation and filing alleviates most of the hidden costs of manual sales tax management. In addition to your information being timely and accurate, no investment in hardware or software is required.

Using SaaS-based technology enables you to benefit from immediate updates without additional IT costs. No capital investment in hardware and software means you can apply the implementation of your sales tax solution to operating expenses versus capital expenditures. Using a solution that enables you to reduce costs and risk as well as improve productivity means you can measure the Return On Investment (ROI) and show the estimated costs of the manual system versus automation.

Manual sales tax management techniques have truly become an unreasonable demand on businesses. Benefits of using the latest technologies to reduce that burden have proven to increase business productivity, reduce audit risk, improve customer and employee satisfaction as well as reduce overhead expense.

Authors:

SHANE RATIGAN began his career as a self-employed business owner. After 10 years in the motorcycle business, he returned to college to gain a Bachelor's in Accounting and a Bachelor's in Business Administration. He went on to his Juris Doctorate at Syracuse University College of Law in New York and his LLM Master's of Taxation at the University of Washington in Seattle. Shane has spent several years counseling small business owners on tax and succession planning. He is a licensed attorney in Oregon and Washington. Shane currently works in sales tax law and sales tax compliance with Avalara, a Software-as-a-Service end-to-end sales tax solution for businesses of all sizes.

USAN MCLAIN began her career as a technical writer in technology industries such as satellite networking and medical devices. Her skills encompass technical and promotional writing, usability engineering, verification and validation testing and protocol writing, requirements development, business analysis, technical illustration/graphic design and marketing. As a self-employed writer for a couple of years, she wrote content for small to medium size businesses including websites, case studies, white papers, end user manuals, blogs and many other marketing and technical documents. She is currently the content specialist for Avalara helping to "make sales tax less taxing.

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