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3 Simple Steps to Documenting Tax Exempt Sales and Avoiding Liability

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The words “sales tax audit” instill great fear in most business owners, but particularly those in the food industry. Restaurant owners are among the most high profile and common delinquent taxpayers in New York state, according to a Bloomberg BNA report (http://litax.lawmarketinglongisland.com/wp-content/uploads/2016/01/FinalBloombergBNA_Restaurants.pdf). Other types of businesses also need to be wary. New York is very aggressive in going after businesses who fail to file sales tax returns or pay taxes owed. The key to avoiding or fighting an audit is implementing appropriate processes into your daily business routines to keep track of your sales properly. Unfortunately, many businesses who otherwise do a good job documenting their sales fall prey to a common sales tax trap - tax exempt sales. In order to protect themselves, owners can follow simple guidelines ensuring these sales don't fall through the cracks.

What Do Auditors Want?

Auditors generally start by asking businesses for two things: sales records and bank statements. Why is this the starting point? Auditors are verifying that records of sale balance with bank statements – in other words, sales equal deposits. They are making sure the business is charging the correct amount of sales tax on taxable sales. If there are non-taxable or tax exempt sales, they want to know why and see proof.

When a business does not charge sales tax, it is the business's responsibility to document and justify the reason. That's where tax exemption certificates come into play. They are the proof you need. It is the merchant's responsibility to ask for, keep a

copy of, and associate the “Tax Exemption Certificate” with the sale. In an audit, failure to have a tax exemption certificate on file for a particular sale often results in the merchant paying the sales tax out of its own pocket.

When Do You Need a Tax Exemption Certificate?

Sales tax exemption certificates enable a purchaser to make tax-free purchases that would otherwise be subject to tax. Within the restaurant industry, examples of tax-free transactions include purchases of certain items for re-sale or for an exempt use. For instance, when foods like candy, soda, bottled water, and other items are purchased to be resold to customers, the restaurant can purchase them tax-free under a resale exemption certificate issued to the supplier.

Another example of tax-free transactions involves purchases by a tax exempt organization. Where a customer is a tax exempt entity, such as a non-profit, government agency, school or religious group, the entity can buy certain goods and services sales tax free, provided it presents a copy of its tax exempt certificate at the time of sale.

How Should You Document Your Tax Exempt Sales?

Successful audits come down to good recordkeeping. The longer the auditor is sitting in your business unraveling your books and records, the bigger the penalty. Because so many businesses don't keep adequate records, tax exempt sales are low hanging fruit for auditors. However, it is easy to be compliant as long as you have this simple process in place:

- 1 Anytime a tax exempt organization asks you to remove sales tax from their order, **require them to give you a copy of their tax exempt certificate**. You should also check that the certificate uses the correct form, all fields have been filled in and that it is signed and dated. If you don't get a correct certificate, the sales tax remains on the sale. No exceptions!
- 2 Print a copy of the sales receipt showing that the sales tax has been removed and attach it to the certificate.
- 3 File the certificate/receipt document for your records in the event of an audit.

The key to protecting your business from a penalty with tax exempt sales is to never remove sales tax for an organization unless they present you with a physical certificate.

Remember that businesses that fail to comply with sales tax rules are subject to significant consequences in New York. Penalties and interest may be imposed; the business may have its Certificate of Authority revoked; or it could face criminal prosecution for failure to pay. In addition, sales taxes are trust fund taxes so owners, operators, and even investors can be held personally liable for trust fund tax debts of the business. New York State can pursue any combination of enforcement methods, such as warrants, levies, income execution and seizure of the business, to collect what is owed. If a taxpayer owes \$10,000 or more in taxes, penalties, or interest, New York can also suspend a taxpayer's New York State Driver's License.

Don't let tax exempt sales fall through the cracks. Follow established procedures to protect your business and avoid liability. Processes now exist that can automatically collect, file and pay your sales tax for you.

If you have questions about a sales tax audit, email ktenenbaum@litaxattorney.com (mailto:ktenenbaum@litaxattorney.com).

If you have questions about sales tax automation, contact david@davotechnologies.com (mailto:david@davotechnologies.com)

Disclaimer: The information contained in this article does not constitute tax advice and is for informational purposes only.

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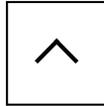
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