GET STARTED MENU

Protecting Your Business and Your Wallet in a Sales Tax Audit

Few words instill fear in a small business owner as much as a sales tax audit. Being a tax collector was certainly not something business owners expected to sign up for when they opened a business. But collecting and keeping track of taxes is a job owners must do and they cannot afford to make it an afterthought or low priority.

Mismanagement or poor record-keeping related to sales tax can lead to excessive fines and penalties, sleepless nights or even jail time. But following a few best practices can help mitigate the risks and hassles of an audit.

Sales tax audits are a necessary part of government oversight to ensure businesses are collecting and paying their fair share of taxes. In the State's eyes, merchants who cheat on sales tax are stealing public funds, giving their business an unfair advantage over competitors. How would you feel if the store across the street was making 8% more profit because they under-reported the sales tax they collected?

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Sales tax is a significant part of most state budgets and they take compliance seriously issuing hefty fines and penalties to businesses who do not play by the rules. Under the law, merchants have a fiduciary or legal responsibility to comply.

Auditors have years of collective knowledge and experience and have seen every trick in the book. So the chance of fooling them is slim to none. They are simply enforcing state laws that make the merchant responsible to collect sales tax, hold it secure and remit it to the State when due.

When you get the notification of an audit, you will have to present the auditor with books and records so he/she may determine the accuracy of the methods used for recording sales, calculating taxes and reporting to the State. The key to success is organization. Remember, the longer the auditor is sitting there unraveling sloppy records, the bigger the penalty is going to be.

Have Clean Records

There are some basic best practices that can mitigate risk and help negotiate a successful sales tax audit. **Start by having clean and accurate books and records**.

Most likely, the first things the auditor will ask for are records of sale and bank statements. Records of sale include register tapes or access to sales data in the cloud if you are using a cloud-based POS. If you are a restaurant, the auditor will ask for guest checks and access to dashboards if you are using third-party apps such as Grubhub. If you are a retailer and you have an online store in addition to your brick and mortar location, the auditor will ask for access to your sales dashboard. What is the reason? Auditors are comparing revenue or dollars into bank deposits to see if sales records align with bank statements.

In other words, they are checking that sales records reflect the same amount as bank deposits. Audits can happen anytime and you are required to keep sales and bank records for several years, depending on what state you are in.

Once the auditor has determined revenue and deposits are in sync he/she will start to dig a bit deeper. Here are some of the biggest tripwires that can trigger an audit or result in other costs to your business:

Late Payments

One of the first things to trigger sales tax audits are the late payment of sales tax. Habitual late payers are asking the State to come and audit them. So make sure to pay sales tax on time.

Tax-Exempt Sales

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A tax-exempt sale is a sale to a non-profit organization sometimes referred to by their IRS classification of 501(c)(3). An example of this would be a religious or school group or sports club. If the organization says they are tax-exempt, they must provide you with a Tax Exempt Certificate to not charge them sales tax.

Additionally, some sales are not subject to sales tax because they fall under an exemption, such as when selling for resale. In those situations, the buyer must provide the seller with a Resale Certificate. It is your responsibility to get the certificate and attach it to their invoice or sales receipt and keep it on file. If you do not charge them sales tax and you do not have a certificate and receipt on file for the group, you will be paying the sales tax out of your own pocket.

Third-Party Apps

Apps such as Grubhub, Ubereats and Doordash all recreate additional streams of revenue which in most cases is outside the POS. It is imperative that apps are managed correctly or they can be costly. Note that the laws around these apps are changing rapidly. If you want to make money on these apps and not get hammered in an audit, be sure you understand how to manage them. Read our in-depth blog post here.

Manager’s Comp

Yes, when you hit the manager’s comp button on the POS to give someone something complimentary, you should be paying use tax on that item. If you use the manager’s comp for staff meals, the restaurant is responsible for the use tax on the comped meal.

If the owner comes in and eats dinner and drinks wine and the meal is comped, they can pay the use tax or claim it as personal income. If tax is not reported on manager comps, it will be up to the owner to pay it out of their own pockets.

If you are facing an audit or you owe sales tax, consult an experienced tax attorney for assistance in resolving your tax matter.

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