Consumer use tax 101: What it is and how to manage it

Avalara
Tax compliance done right

Disclaimer

While we hope you'll find this discussion helpful, this session is for informational purposes only and is not legal or tax advice.

Avalara
Safe harbor statement

Avalara CRUSH

NOVEMBER 11-14, 2024
FAIRMONT AUSTIN

Our biggest customer event is returning this November in Austin! Avalara CRUSH is designed to take the tax compliance conversation deeper — attendees will learn how to make the most of Avalara solutions, get insights on trends in AI and the global economy, collaborate with peers, and network at fun evening events.

It's more than a conference. It's CRUSH.

Continuing Professional Education (CPE)

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Meet your presenter

Meet your presenter

Naveen Agrawal

Principal Product Manager, Avalara

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Naveen is a Principal Product Manager in Avalara's product team. He leads the development of their tax calculation platform (AvaTax) and is currently focused on developing the Accounts Payable solution. Naveen has been with Avalara for more than
12 years and has worked extensively on Avalara's integrations as well as building and launching new functionality in AvaTax.

Agenda

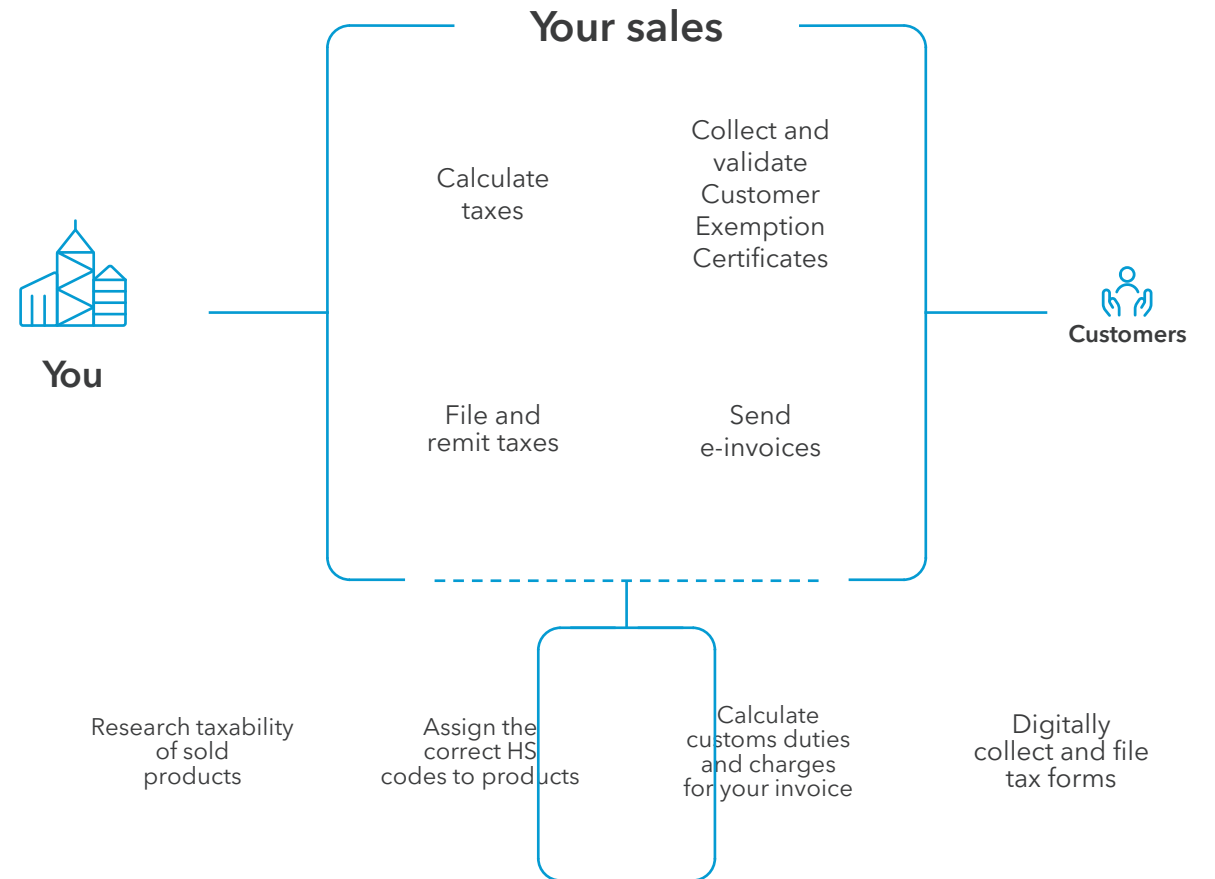# Use tax compliance & Avalara

Vendors

You

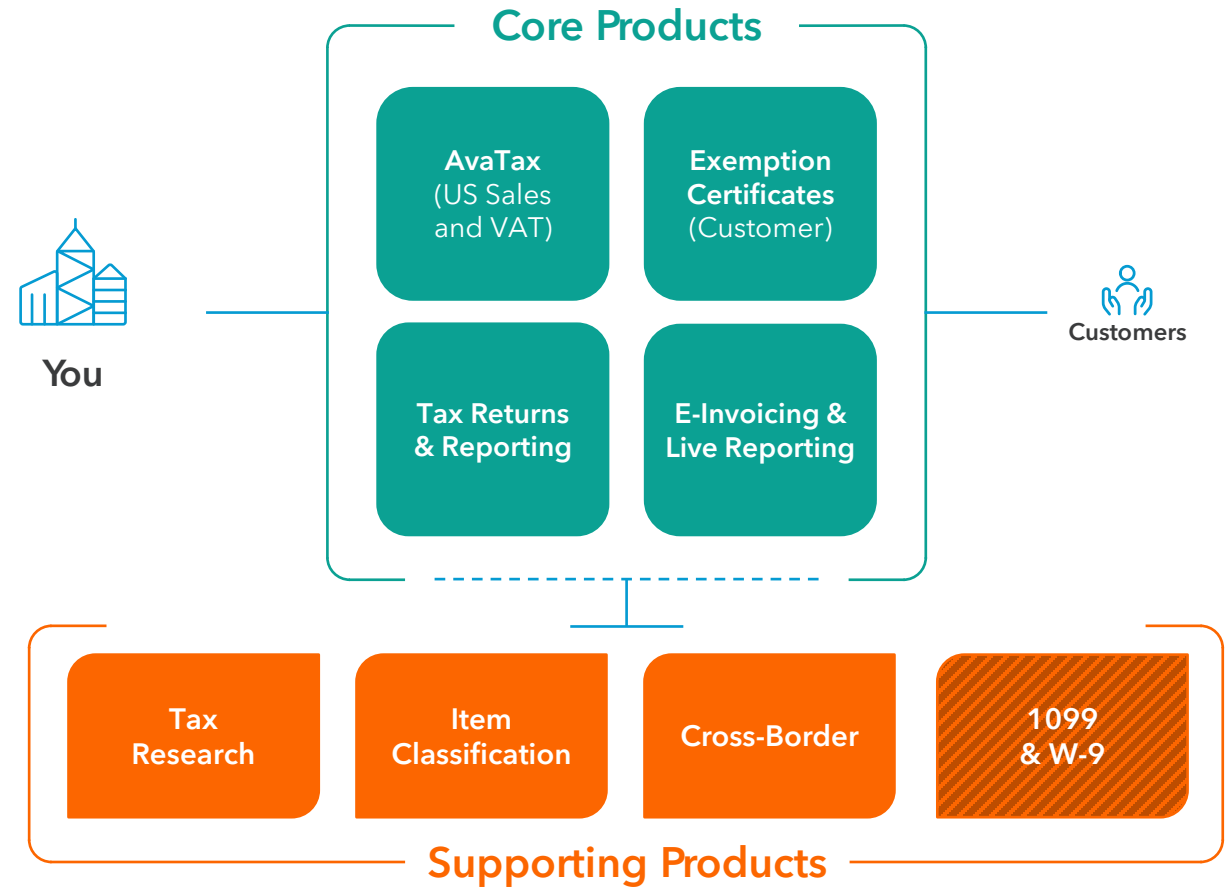**Customers**

Comply with business licenses & tax registrations

Assess your tax compliance risk and submit voluntary disclosures
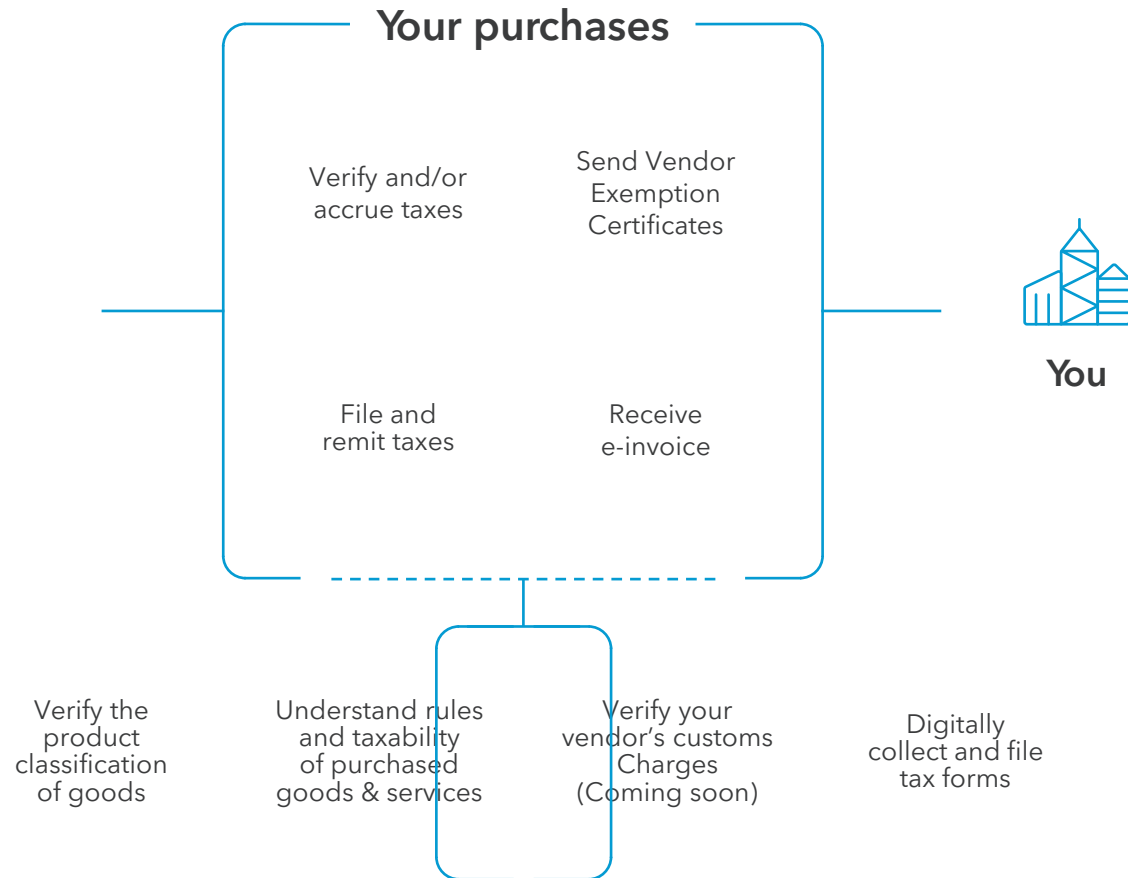
Manage property tax assessments and returns
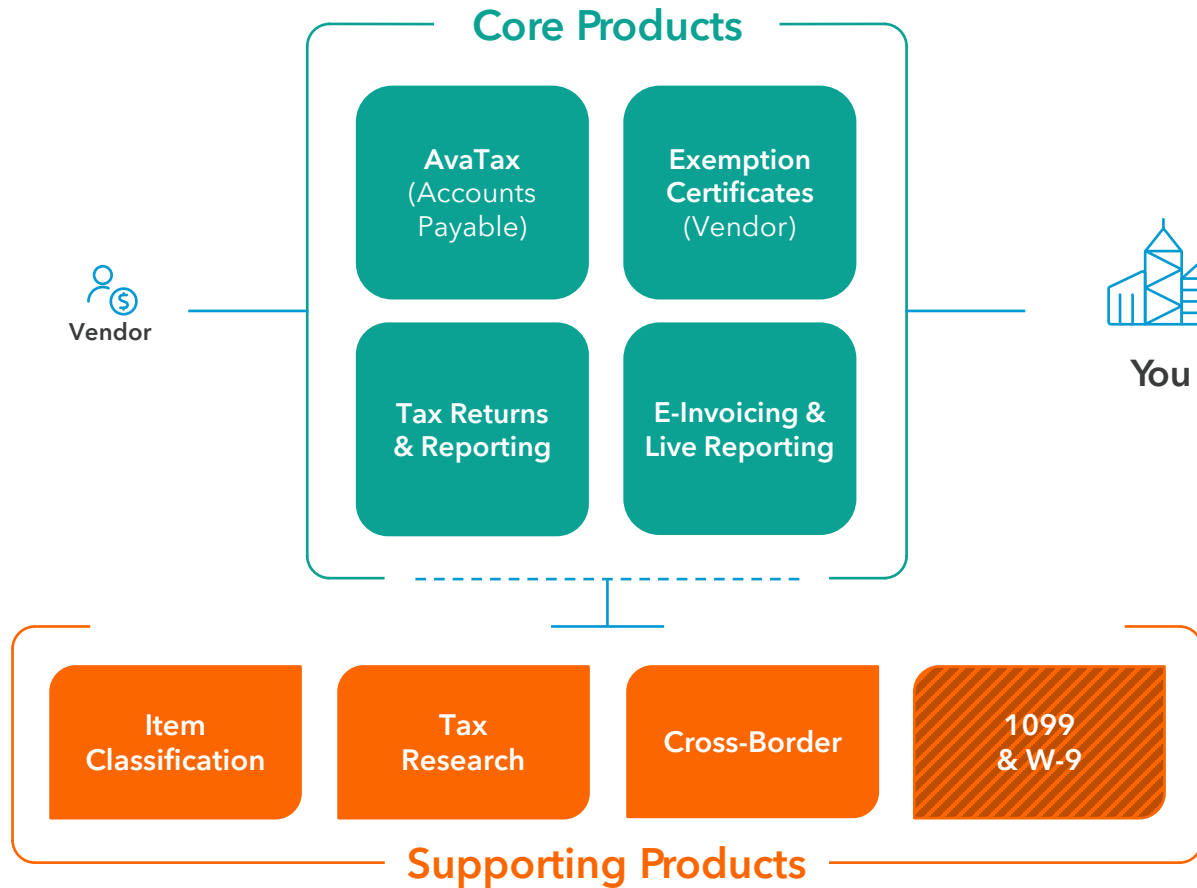
Avalara sales compliance products

Your sales

Calculate taxes

Collect and validate Customer Exemption Certificates

You

Customers

File and remit taxes

Send e-invoices

Research taxability of sold products

Assign the correct HS codes to products

Calculate customs duties and charges for your invoice

Digitally collect and file tax forms

Avalara sales compliance products

You

Core Products

AvaTax
(US Sales and VAT)

Exemption Certificates
(Customer)

Tax Returns & Reporting

E-Invoicing & Live Reporting

Customers

Tax Research

Item Classification

Cross-Border

1099 & W-9

Supporting Products

13

Avalara procurement compliance products

Your purchases

Verify and/or accrue taxes

Send Vendor Exemption Certificates

File and remit taxes

Receive e-invoice

You

Verify the product classification of goods

Understand rules and taxability of purchased goods & services

Verify your vendor's customs Charges (Coming soon)

Digitally collect and file tax forms

Avalara procurement compliance products

Core Products

- AvaTax (Accounts Payable)
- Exemption Certificates (Vendor)
- Tax Returns & Reporting
- E-Invoicing & Live Reporting

Vendor

You

Supporting Products

- Item Classification
- Tax Research
- Cross-Border
- 1099 & W-9

Overview

From the tax rates charged at checkout to IRS forms and even your accounts payable — managing procure to pay has a lot of moving parts.

Use tax is just one piece of the puzzle.
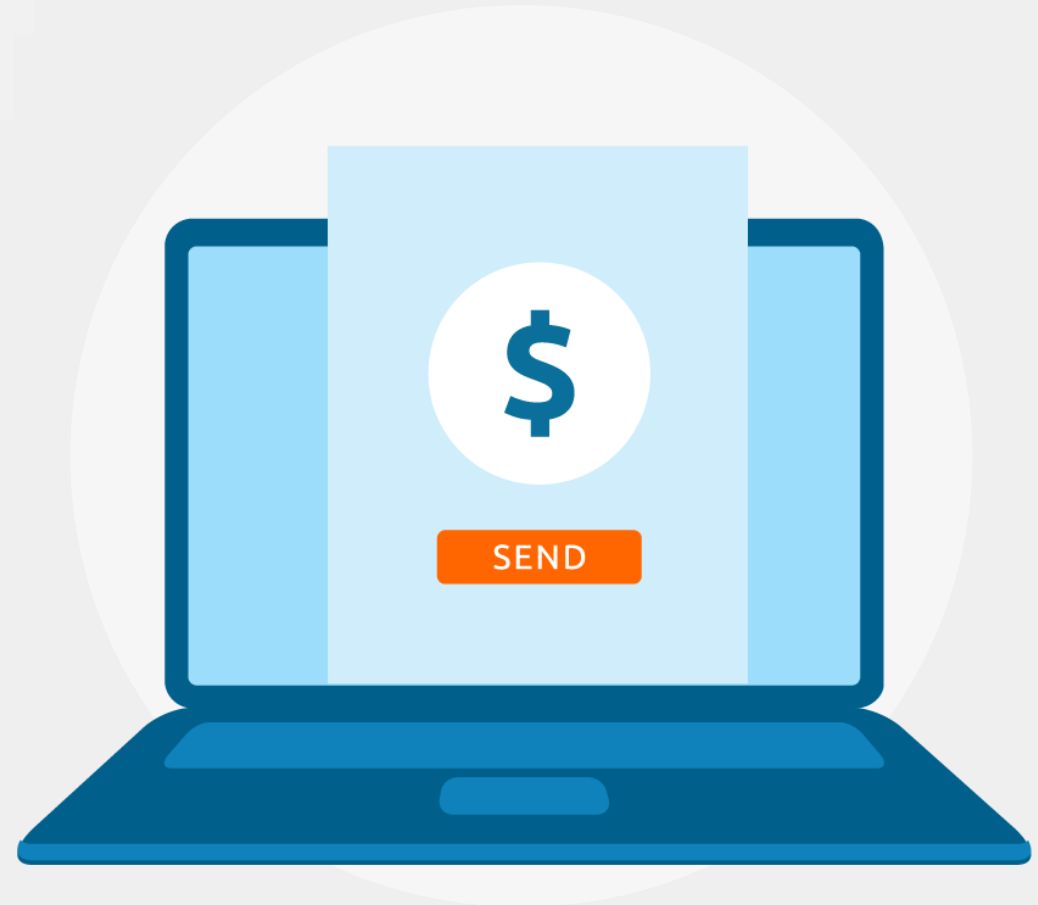
What is consumer use tax?

What is consumer use tax?

Consumer Use:

The tax that is owed by a buyer when they are not taxed the full amount owed on a purchase by the seller.

Change of disposition (usage reason or location) can also trigger the tax.

Typical examples:

- Out-of-state vendor did not collect any or all owed tax

- Purchase was originally put in inventory and was going to be resold, but instead was used

- Purchased in one jurisdiction, put into service in another

Less common examples:

- Free giveaways

- Internal service distribution

- Movement of fixed assets

Consumer use tax challenges

Self-assessment is a manual, resource intensive process requiring specialized skills

Use tax rules and rates are complex and subject to change

Integration and automation are difficult: tax triggers come from many sources & data management is complex

Audit risks are high

Consumer use tax challenges

Vendor invoices with tax errors

Internal service distribution

Promotional items

Employee expenses / purchase cards

Zero-dollar invoices

Inventory internal use

Materials included project & services

Self-assessment process

G/L accruals

Sales & Use Tax Returns

Purchases delivered to one location and distributed to others

Capital asset movements

Inventory movement & aging

Real Property, Capital Improvements & Repairs/Maintenance

Vendor invoices from vendors without nexus

Scenario: Purchases from outside the "use" jurisdiction

Most common

Common errors at time of purchase:

- Out-of-state purchases without tax

- Sales tax that does not consider local jurisdictions

- Sales tax incorrectly undercharged

- Poor invoice details or no invoice

- Business inputs purchases without exemption certificate

- Paying the wrong consumer use tax based on location of use

Scenario: Changes in disposition – use or location

Where something moves and how materials are "used" changes taxability

Common errors in disposition:

- Purchase in one location and shift purchase to another location with higher tax rate without self-assessing consumer use tax on the difference

  - Centralized purchasing
  - Internal service distribution

Software company

Headquarters: in the "special zone" of NJ
Sales tax rate: 3.3%

West cost "center of excellence" in Seattle WA
staf there is 62% of sales and support folks

Salesforce bill of $750,000, billed to HQ
Sales tax charged: $ 24,750

However, with 60% of Salesforce users in Seattle…
Sales/Use tax rate in Seattle: 10.4%

62% of $750,000: $ 465,000
Use tax delta due: **$ 33,015**

Scenario: Change in disposition

Where something moves and how materials are "used" changes taxability

Common errors in disposition:

- Purchase in one location and shift purchase to another location with higher tax rate without self-assessing consumer use tax on the difference
    - Centralized purchasing
    - Internal service distribution
- Buying materials for manufacturing or resale tax-free, then using them internally
- Not understanding that the use of certain materials in certain ways constitutes "internal use," depending on a particular state's rules
    - E.g. "fix-bid" contract vs. "time & materials"

Construction Contractor

Company size: Approximately 90 employees

Revenue: Approximately $200M

- Conducts business in 12 states with offices located in 4 states
- Maintains head office in Nevada
- Audited by State of Nevada

Reason selected for audit: Numerous errors in Returns filed over the years.

Audit period: 2012 – 2014

Construction contractor issued resale certificates in purchasing building materials such as nails, caulking, paint, cement. Use tax was not self-reported.

Cost: Auditor assessed $475K in use tax plus penalty.

Challenge: Record keeping and purchase invoices were incomplete prompting auditor to estimate tax at $650K before documentation was provided to lower the assessment to $475K.

Lookback period: 1 year.

Scenario: Special cases

CUT is a liability mine field….

Uncommon situations to consider:

- Free samples / giveaway items

- Incorrect taxation of shipping/handling

- Capital improvements

- Special rules for denial of credit on another state's sales tax paid for specific goods shifted into another state (reciprocity)

- Inventory usage or aging

- Fixed asset movement (6-month rule)

- Special rules and rates for software/digital goods or for services

- Direct pay and multi-use permits

- Gaps in state-to-state reciprocity

How to manage consumer use tax

How do companies manage consumer use tax liability?

Overwhelmingly the answer is "with difficulty"

Strategies to manage varies wildly:

- Ostrich mode
- Best guess lump sum payment
- Manual paper invoice sampling in batch
- Spreadsheet manual audit (subset of invoices)

- Manual invoice inspection at time of invoice
- Programmatic evaluation at time of invoice
- Internal reverse audit with Support Software
- External multi-year reverse audit
- Outsource entire process (big 5 firms)

What strategy is best?

As with all thing consumer use tax, it depends

Make a point to consider the following:

- Data capture is key

- Consumer use tax needs to be designed around your day-to-day operations

- Design you program to account for change

  - Changing laws

  - Changes after goods/services are acquired

- There are key documents you will need to manage

- Again, have an audit strategy

Introducing AvaTax for Accounts Payable

Catching vendor errors

- Most common consumer use tax issues occurs when **vendors omit or incorrectly charge sales tax**

- **AvaTax for Accounts Payable** checks rates according to jurisdiction, product taxability, and any special rules that may affect the purchase, making it easier for you to manage compliance
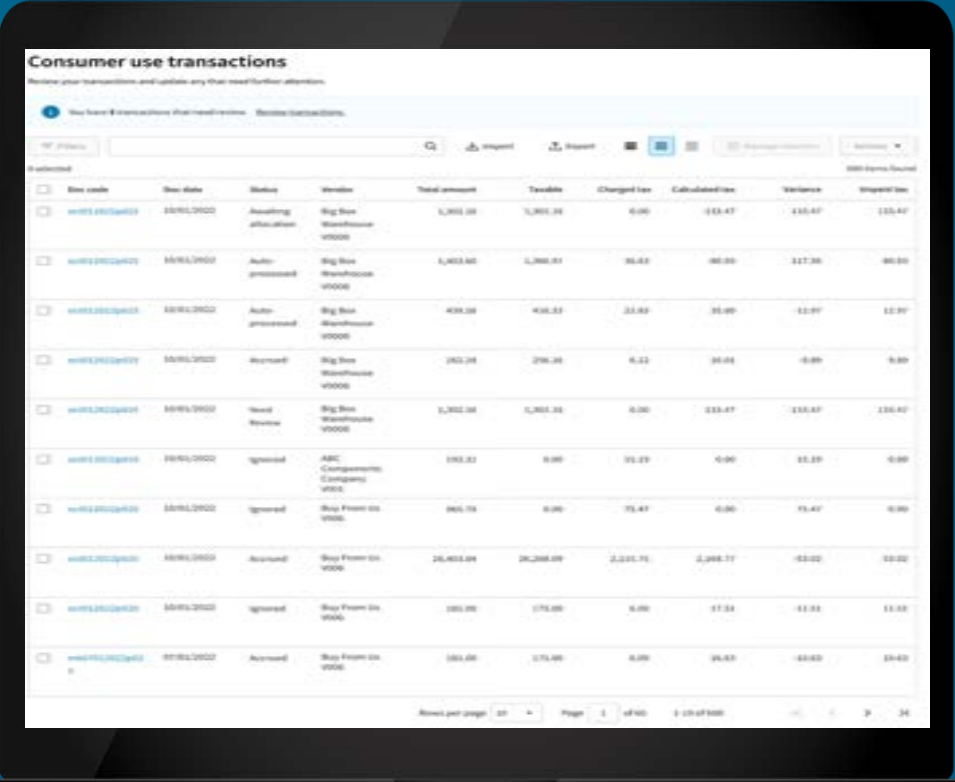
Introducing...
AvaTax for Accounts Payable

Product overview

- Process automation for consumer use tax self-assessment

- Flexible transaction import from any source, including real-time support

- Configurable rules to support automated and semi-automated processes

- Powerful reporting for process control, G/L journal entries, audit trails, and liability analysis

- Integrated with Avalara Returns

AvaTax for Accounts Payable demo

Q&A

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