



# Direct Pay & Compliance Agreements

## Solutions To A More Efficient Compliance System

### EHTC State and Local Tax Services

#### INCOME & FRANCHISE TAX

- Tax Minimization Studies
- Business Structure Reviews
- Allocation and Apportionment Planning
- Combined, Consolidated, & Unitary Planning
- Nexus Studies
- Amended State Tax Returns from IRS Audits
- Single Business Tax Training

#### SALES & USE TAX

- Reverse Audits
- Compliance System Review
- Direct Pay & Compliance Agreements
- Exemption Certificate Documentation
- Industrial Processing / Manufacturing Exemption
- Utility Studies
- Nexus Studies
- Sales & Use Tax Training
- Transportation Company
- Procurement Company

#### PROPERTY (AD VOLEM) TAX

- Real Property Tax Reviews
- Personal Property Tax Reviews

#### TAX AUDIT & APPEALS

- Sales & Use Tax Audit Defense & Appeals
- Income & Franchise Tax Audit Defense & Appeals
- Property Tax Audit Defense & Appeals
- State and Local Tax Litigation Support
- Merger & Acquisition Due Diligence Reviews
- Voluntary Disclosure

#### BUSINESS INCENTIVE SERVICES

- Business Relocation & Expansion Services
- Tax Credits, Exemptions, & Abatements
- Grants, Financing, & Infrastructure Assistance

EHTC offers a new and greatly simplified method of determining the use tax liability on purchases. The "single rate" method has already been accepted by several taxing authorities for use with relatively large taxpayers.

### The Traditional Compliance System

The traditional use tax compliance system requires the preparation and submission of exemption certificates in order to obtain exemptions provided by law. Some states allow the use of blanket exemption certificates. If the claim for exemption is not rendered, the seller will most often charge tax on an item that may be exempt.

With the traditional system, the accounts payable function has the responsibility to review purchase invoices to identify tax charged in error on exempt purchases. Failure to identify such purchases can result in an overpayment of tax. The accounts payable function may have the responsibility to determine the taxability of purchases and accrue the use tax on purchases without sales tax.

The traditional system places a demanding burden on the purchasing and accounts payable functions. Individuals working in these functions often do not have the training and knowledge necessary to make accurate determinations as to the taxability of purchases. Excessive growth, downsizing, and turnover can result in the collapse of the compliance system and substantial overpayment of tax.

### Direct Pay Permit or Authorization

The alternative to the traditional use tax compliance system starts with a direct pay permit or authorization. Many states have statutory authority for granting such authorization while other states allow taxpayers to pay the tax directly. The direct pay permit or authorization allows the taxpayer to purchase all tangible personal property exempt from sales tax. The taxpayer then has the responsibility to pay use tax on the taxable purchases directly to the state. The direct pay process is subject to audit. The direct pay permit or authorization allows the taxpayer to purchase only tangible personal property exempt from tax.

The advantage of the direct pay alternative is that the purchasing function is relieved of making taxable/nontaxable determinations on all purchases. They simply use the direct pay permit to purchase everything exempt from tax. However, the accounts payable function still has to identify on an invoice-by-invoice basis the taxable purchases and then remit tax thereon. Failure to identify and pay tax on taxable purchases can result in costly audits and penalties.



## About EHTC

Echelbarger, Himebaugh, Tamm & Co., P.C. (EHTC), a professional corporation was established in 1977 by Dennis M. Echelbarger. Since that time, our Firm has grown to become one of the largest, most successful, local accounting firms in the Greater Grand Rapids, Michigan area, and we are a recognized leader in the business community. Our success is based on building partnering relationships with our customers. We are large enough to serve a wide diversity of customers but small enough to maintain personalized attention.

EHTC's professional team is highly trained to provide technical and consulting services in the areas of accounting, taxes, and strategic planning to nonprofit, profit and service organizations and related entities.

Minimizing your tax liability requires careful, advance planning rather than preparing tax returns as deadlines near. Our tax professionals provide complete tax services and are assisted by our extensive tax library and the latest technology.

We pay careful attention to your unique circumstances such as your current requirements and your plans for the future. We then recommend a plan that best suits your needs while minimizing financial risk.

## The Single Rate Use Tax Compliance System

Under the alternative to the traditional use tax compliance method, the taxpayer computes a specific "single rate" to be applied to the purchases to determine the taxable purchases. This varies greatly from the burdensome traditional method, which requires the taxpayer to track every single item it purchases to ascertain whether the item is taxable and what rate of tax applies. Each month the taxpayer multiplies the "single rate" by the total purchases to determine the use tax due and remits the same to the state. There are no exemption claims to be made or invoices to review. The "single rate" system is still subject to audit.

The "single rate" would be based on the use of historical values for taxable purchases and total purchases made. This percentage is calculated using a statistically valid sampling technique that would result in an acceptable level of confidence and precision in the accuracy of the estimated percentage. The statistically valid sample is selected from a specifically determined population, usually a one-year population of purchase invoices. Computerized random selection techniques are used to guarantee that every item in the population has an equal chance of being selected. Stratification of purchases is used to achieve the desired level of reliability and precision. The selected invoices are reviewed and the tax due on the taxable invoices is compiled. The tax due on the sampled invoices is divided by the total dollar amount of the purchases sampled to compute the "raw percentage". Statistical mean estimation techniques are used to project the sample "raw percentage" to the "single rate". This "single rate" would be multiplied by the total amount of purchases to arrive at the tax liability.

## Compliance Agreements

The benefit of the "single rate" compliance method is obvious. However, it is still subject to audit. The state could determine the tax using a completely different audit method, a method that may result in a tax deficiency.

As an alternative to this risk, the taxpayer may want to enter into a Compliance Agreement with the state. Both the taxpayer and the state would agree in writing to the sampling technique and tax treatment of the items in the population.

Such agreements provide safeguards to protect the interests of both the taxpayer and the state. First, the state and the taxpayer would mutually agree upon the statistical method to be used. Second, the statistical sample would be re-determined on a specific schedule, such as once every two to four years. Finally, upon proper advance notice, the agreement could be modified if either the client or the state believes that the method is consistently and substantially inaccurate in application.