

Understanding Sales and Use Tax Issues

Issues & Options for Commercial Card Accounts



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Introduction

Sales and use taxes can present special challenges for companies when card account programs are used for procurement, especially those with larger volume programs. This white paper provides an overview of these sales and use tax issues, including:

- ▶ Definitions of the taxes as well as key terms such as Nexus
- ▶ Information on potential sales tax exemptions a company may encounter
- ▶ Estimation as a tool to manage use tax issues
- ▶ Best practices to ensure compliance with applicable tax laws and to provide adequate supporting documentation in case of audit
- ▶ Examples of sales and use tax applicability to help clarify the types of transactions that require collection and remittance of sales and use taxes

While this document introduces the sales and use tax issues associated with purchasing card accounts and other commercial charge products used for procurement, it is not intended to provide tax, legal, or accounting advice. Before using this information to establish policies or determine the taxability or exemption of transactions, suppliers, or cardholders, it is recommended that you review the issues thoroughly with your tax, accounting, and/or legal advisors.

Overview of Sales and Use Taxes

Most states and many local governments levy a tax on the production, use, or consumption of goods and services. This tax takes a variety of forms—the most common being sales and use tax. Currently, every state imposes sales and use taxes except Alaska, Delaware, Montana, New Hampshire, and Oregon.

In recent years, states have become increasingly aggressive in the sales and use tax area through both legislative changes and enforcement. In many states, the likelihood of being audited has increased, and companies need to be prepared for challenges. Effective preparation includes issue identification and resolution, as well as the establishment of adequate policies and procedures.

Definition of Sales Tax

The sales tax is a transaction tax, calculated as a percentage of the sales price. A sales tax may legally be imposed on the seller or the purchaser, but in either case, is typically collected by the seller from the purchaser, and remitted to the state. The tax is usually imposed on sales of tangible personal property and selected services. The definition of a taxable sale varies by state, but generally includes:

- ▶ Transfer of title or possession of taxable tangible personal property for consideration
- ▶ Exchange, barter, lease, or rental of taxable tangible personal property
- ▶ Performance of a taxable service for consideration

Definition of Use Tax

The use tax (in some states referred to as a compensating use tax) is a companion tax to the sales tax. In general, the use tax is imposed on transactions that would have been subject to the sales tax if both the buyer and the seller were located in the same state. It is usually imposed on the use, storage, or consumption of tangible personal property in the state.

The use tax often applies when a company makes a purchase from an out-of-state seller that is not required to collect sales tax in the purchaser's state. If the seller does not collect the tax from the purchaser, and the purchase is otherwise taxable, the purchaser is responsible for remitting use tax to the state.

Transactions that may be subject to use tax include:

- ▶ Purchases from mail order companies that are not required to collect sales tax in the state of delivery
- ▶ Deliveries from out-of-state companies that are not required to collect sales tax in the state of delivery
- ▶ Taxable transactions with in-state merchants receiving a blanket resale or exemption certificate from the buyer
- ▶ Purchases from an out-of-state or in-state merchant that is required to collect sales tax but that, in fact, does not

Example: A purchasing manager for ABC Manufacturing Co. in California decides to purchase calculators for use by the accounting department personnel. The manager decides to purchase these calculators from XYZ Co., an Illinois merchant that sells through the mail. After the calculators are ordered, XYZ has them delivered via common carrier. The invoice from XYZ does not include any sales tax. In this case, since the calculators would have been subject to sales tax if they had been purchased in California, ABC must self-assess and remit the use tax due on the purchase to the state of California.

Taxable Tangible Personal Property

The assumption that all sales of tangible personal property are taxable, unless a specific statutory exemption is provided, helps ensure compliance. The term “sale” includes installment and credit sales, exchanges of property, and the transfer of tangible personal property for valuable consideration.

Exemptions

The most common exemptions from sales and use taxes include:

- ▶ Purchases by certain types of exempt organizations:
 - Federal, state, or local governments
 - Non-profit organizations such as hospitals
- ▶ Purchases specifically designated as exempt:
 - Prescription medication and medical supplies
 - Occasional or casual sales (e.g., sale of an old lawnmower to a neighbor)
- ▶ Purchases qualifying for exemption based on the manner of use:
 - Raw materials used in manufacturing
 - Machinery and equipment used directly in the manufacturing process

The taxability of specific transactions and the availability of exemptions vary widely from state to state, and the identification of taxable and non-taxable transactions requires a company-by-company and state-by-state analysis.

Example: A purchasing manager for A-Plus Fax Machine Manufacturing Co. in Texas wants to purchase certain repair parts for its manufacturing equipment. She also needs to purchase office supplies to be used in A-Plus' personnel department. In addition, A-Plus has received an order for its top-of-the-line fax machines, but is unable to fill the customer's order, and must purchase the machines from another manufacturer.

The purchasing manager buys the repair parts and the fax machines from a vendor based in Texas, and the office supplies over the Internet from a Florida company not required to collect sales tax in Texas.

In this case, A-Plus must pay use tax on the office supplies since they are taxable in Texas and no sales tax is charged on the invoice A-Plus received from the Internet company.

The repair parts are exempt in Texas so no sales tax should appear on the invoice, and none is due. The fax machines would normally be taxable, but because A-Plus plans to resell the machines, it can present a resale certificate to the merchant to exempt the purchase. A-Plus will be required to bill sales tax, assuming its customer is the end user located in the same state as A-Plus.

Taxable Services

Services subject to sales and use tax vary widely from state to state. The taxation of services has historically been limited to sales of utilities and amusements. In recent years, however, many states have broadened their tax bases to include additional services, such as repair and installation of equipment, data processing, landscaping and building maintenance, and telecommunication services.

Nexus

Nexus is a legal term that describes the concept of having a strong enough link or connection to a jurisdiction to allow the imposition of a tax. In short, nexus is the benchmark that determines whether a sales tax can be imposed and whether a merchant can be held responsible for collecting the tax. If a company does not have nexus with a particular state, that state may not impose tax upon the company or require it to collect sales tax.

As a general rule, an out-of-state seller will be deemed to have nexus in a state for sales and use tax purposes if it has regular and systematic contacts with that state, mostly through employees, agents, or property. This means that a mail order company or company making sales over the Internet will have nexus only in the states where it has property, such as an office or warehouse, or employees. A company's state of incorporation and its registration status for sales and use tax purposes will also affect its obligation to collect and remit sales

and use taxes. The nexus standard for sales and use tax is different from the standard applied for income tax, and it is possible for a company to have nexus for sales and use tax purposes but not for income tax purposes.

Nexus is an important factor in determining a company's responsibility to collect sales or use tax and to self-assess tax. An out-of-state merchant that does not have nexus in the state where the goods are delivered is not required to collect sales or use tax for sales made in that state. Rather, the burden falls on the purchaser to self-assess the use tax.

Example: ABC Manufacturing Co., based in Texas, manufactures office equipment. The company receives an order for a retail sale of two fax machines for use in offices located in Illinois and California. Currently, ABC has a distribution center and sales office in California and therefore has nexus with this state due to these significant contacts. ABC has no contact in Illinois, where its only activities are the shipment of goods via common carrier to customers in that state, and thus does not have nexus with Illinois.

Since ABC does not have nexus with Illinois, ABC is not required to collect sales tax for the fax machine delivered to Illinois. The office in Illinois that is purchasing the fax machine, however, is required to self-assess the use tax, if there is not an exemption on such purchases in the state where the fax will be used. Because ABC has nexus with California, it is required to collect California sales tax on the transaction and submit the tax to the state.

Tax Model Objectives

The primary objective of developing a tax model is to eliminate the need to make a tax decision on each purchase transaction. It is not practical or cost-effective to analyze every purchase transaction in a high-volume purchasing card environment. In addition, the dollar amount of individual transactions may be too low to justify the investment of time required for skilled personnel to review each transaction.

While the process of calculating the use tax accrual may change, the goals of the tax model remain the same as in the traditional purchasing process:

- ▶ Managing transaction taxability
- ▶ Managing tax compliance
- ▶ Managing audit accountability

In managing transaction taxability, the model must be capable of accurately identifying transactions where tax was correctly charged, transactions where tax was not charged because the goods or services are exempt from tax, and transactions where tax was not charged and use tax must be accrued. The complexity of this issue will vary by industry.

Manufacturing organizations, for example, typically incorporate more complex criteria into their tax models because certain equipment and material used or consumed in the manufacturing process may be exempt from tax. A service organization, on the other hand, does not have many opportunities to purchase goods or services exempt from tax, so it may develop a less complex model.

As with the traditional paper-based purchasing process, the purchasing department coordinates its activities with the tax department to correctly implement the tax model. The tax department is most often responsible for identifying taxable and exempt purchases and providing the appropriate rates for the use tax calculation. In addition, it is important to coordinate the flow of information provided by the model with the tax department to establish an efficient transfer of the use tax accrual to the correct sales and use tax return.

Procedures are carefully examined and rigorously tested during a state taxing authority audit; therefore, to add value to the tax function, a procedure should both:

- ▶ Accurately calculate the amount of tax due
- ▶ Document the calculation with an easily reviewable audit trail

The tax model can reduce the burden of sales and use tax audits by simplifying the audit review process.

Calculating Use Tax on Transactions: Introduction to Developing a Tax Model

Companies often make purchases from merchants that are not required to collect, or that do not otherwise collect, the applicable sales tax. For these purchases, the company must establish policies to calculate or estimate the use tax due. This is true both for purchases made through the traditional purchasing process and for purchases made with a purchasing card or other commercial account.¹

¹ Throughout the remainder of this paper, commercial charge accounts are referred to as purchasing cards or purchasing card accounts. Readers should note that any time a charge account number is issued to a business for acquisition of goods and services to be used in the course of conducting that business, these concepts will likely apply. This would include purchases made with “ghost” or cardless accounts.

In a purchasing card program, three general approaches may be used to manage the accuracy of a company's use tax calculation:

- ▶ **Exclusion Policy** attempts to exclude all transactions that may require a use tax accrual.
- ▶ **Basic Use Tax Estimate** calculates use tax on all purchases from out-of-state merchants.
- ▶ **Refined Use Tax Estimate** attempts to segregate transactions for which sales tax was most likely paid from transactions for which it is not likely that sales tax was paid, and therefore a use tax accrual is needed.

The following table summarizes the three approaches for estimating use tax liability:

Exclusion Policy	Basic Use Tax Estimation	Refined Use Tax Estimation
Restrict the use of purchasing cards to purchases where sales tax is charged.	Calculate use tax on all purchases from out-of-state merchants.	Calculate use tax on all purchases from out-of-state merchants that did not charge sales tax, excluding those purchases that qualify for exemption.

Exclusion Policy

Under this policy, purchasing cards cannot be used for transactions with out-of-state merchants that do not collect sales tax, or for transactions that are generally non-taxable, such as purchases of manufacturing supplies and goods for resale. Also excluded are mixed transactions, where both taxable and non-taxable purchases are reflected on the same invoice or are charged as a lump sum, and other transactions with potential sales and use tax issues.

The exclusion policy restricts the use of card accounts to only taxable transactions where sales tax was charged. Card accounts may not be used to purchase from out-of-state merchants and mail order companies.

NOTE: In most cases, this approach is not practical since many purchases are, in fact, made through out-of-state merchants, such as mail order companies or Internet-based suppliers. For example, when orders are placed over the phone, the order-taker frequently does not know if a tax is charged for a particular jurisdiction until the order is entered. *Because of these limitations, the exclusion policy is likely to diminish the benefits and efficiency of a card program.*

Basic Use Tax Estimate

This approach calculates the use tax on all transactions with out-of-state merchants that ship goods into the state where the cardholder is located. The use tax estimate is made without regard to whether or not an out-of-state merchant actually charged sales tax and without regard to available exemptions and exclusions on those transactions.

This is a simple approach that does not restrict the use of card accounts, but results in over-accrual of use tax because a number of out-of-state merchants do, in fact, collect the tax due on the transaction.

Refined Use Tax Estimate

This approach expands upon the basic use tax estimate by attempting to review a broader range of transactions for taxability. Transactions identified as exempt can be excluded from the use tax estimate by a combination of cardholder/account information and merchant information. For example, transactions from out-of-state merchants that properly charge sales tax are excluded from the use tax calculations, as are exempt transactions. This approach can identify a greater number of exempt transactions and reduce the probability of the overpayment of tax. However, the added level of accuracy with this approach requires adequate planning and administration for its effective implementation.

Example: A purchasing manager for ABC Manufacturing Co. in Texas makes purchases from a pool of 5,000 merchants, 3,000 of which are in-state and properly charged sales tax and 2,000 of which are out-of-state. Half of the out-of-state merchants do not charge sales tax.

In this example, the organization may choose to adopt one of three approaches to estimate the use tax liability for the out-of-state purchases.

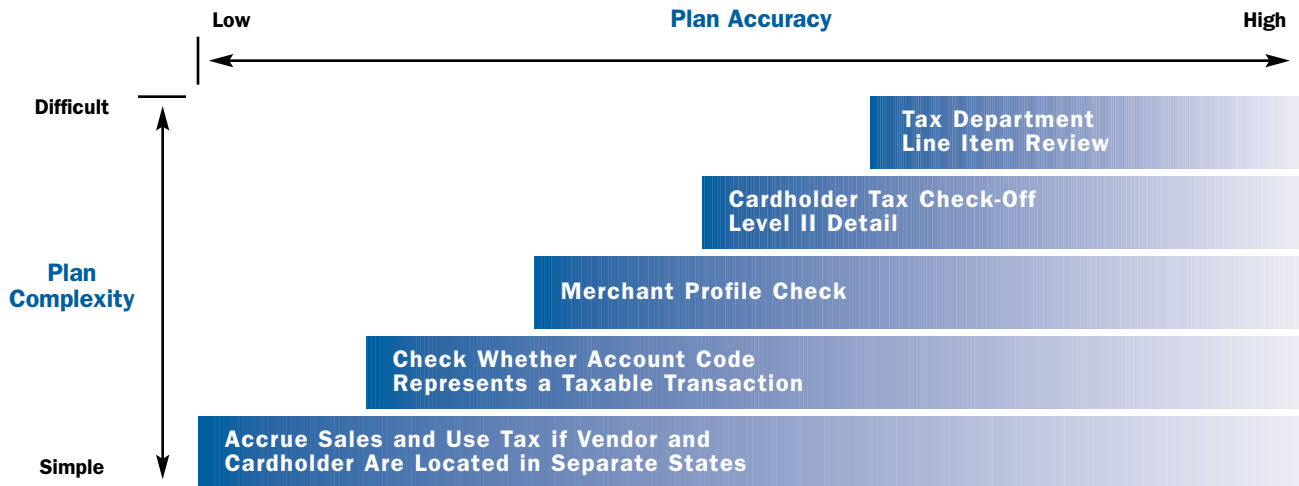
Exclusion Policy. Cardholders may only make purchases from the 3,000 in-state merchants and the 1,000 out-of-state merchants that charge sales tax. Since they may not make purchases from the 1,000 out-of-state merchants that do not charge sales tax, the benefits of the purchasing card system are diminished.

Basic Use Tax Estimate. A use tax calculation is performed for the entire pool of out-of-state transactions.

Refined Use Tax Estimate. From the pool of all out-of-state transactions, transactions with the 1,000 out-of-state merchants that properly charge sales tax are excluded. Also excluded are transactions made using exempt cardholders' job accounts, and merchants from which ABC purchases exempt products or services.

Five-Level Best Practice Model

This model provides the best practices used by corporations studied in connection with the Visa Purchasing Card Sales and Use Tax Study. The model assumes that a use tax accrual will be calculated for all transactions that cannot be eliminated from the accrual base by implementing one or more of the best practices. An organization may implement one or more of the practices and may apply them in any order.



Practice 1: Eliminate Transactions from the Accrual if the Cardholder and the Merchant Are Located in the Same State

Under Practice 1, transactions in which the cardholder and the merchant are located in the same state are eliminated from the calculation of the use tax accrual. This practice is based on the understanding that in most states it is the merchant's responsibility to charge tax on all taxable transactions where goods or services are delivered in state.

The only situation where a merchant should not charge tax on an in-state transaction is when the purchaser has provided the merchant with a valid exemption certificate. The purchaser would be able to provide a valid certificate if, for example, the goods were purchased for an exempt purpose, such as manufacturing, or when purchased for resale.

This practice, when automated, is very simple and can provide an acceptable level of accuracy for some companies, especially those that conduct a significant amount of their purchasing with merchants located in state.

It is important to note, however, that in-state transactions that are eliminated from the use tax accrual should be sampled and tested to verify that the assumption is valid. There are situations where in-state merchants may not charge tax on all transactions; for example, when they have received erroneous exemption certificates or have mistakenly classified the purchaser as exempt in their sales tax collection system.

Practice 2: Check Whether the Account Code Represents a Taxable Transaction

This practice looks at the account code to which the transaction was charged to determine if there may be sales or use tax implications. For example, a charge to a professional service account code, in many states, would not raise sales or use tax issues. A charge to the miscellaneous supplies account code could, however, have sales or use tax implications, since this account is usually used to purchase tangible personal property that would be subject to sales tax. The account codes referred to above may be either cardholder account numbers or general ledger account numbers.

When automated and used in conjunction with Practice 1, this practice increases accuracy and reduces audit exposure without significantly increasing the complexity of managing the card program. Combining Practice 1 and Practice 2, however, may not be sufficient to achieve the desired balance between accuracy and complexity. Typically, the accrual will be calculated on all the remaining transactions, so it may include some transactions where tax was already paid.

Practice 3: Merchant Profile Check

This practice establishes merchant profiles, identifying in-state merchants registered to collect tax. It can also be used to classify merchants as exempt or as being subject to sales or use taxes based on the types of goods or services sold.

Exempt merchants include companies such as law firms, while merchants subject to sales and use taxes may include those engaged in the sale of tangible personal property in interstate commerce. This classification method further enhances the card program tax calculation accuracy and, when used in combination with Practices 1 and 2, can further increase the accuracy of the calculation.

Maintaining merchant profiles, however, is likely to require more time than implementing Practices 1 and 2. The critical question for the organization to answer is: how much of the time spent establishing merchant profiles contributes value (measured by accurately reducing the use tax accrual) to the organization?

Practice 4: Cardholder Tax Check-Off

This practice requires cardholders to check off transactions that are potentially subject to sales and use taxes on work papers or logs provided by the tax department. Cardholders may indicate that tax is included on the receipt or that tax needs to be accrued.

Over the past few years, the cardholder tax check-off process has been automated by a number of organizations, so that information previously obtained from manual logs or work papers is now gathered via an electronic reporting system.

Regardless of how the cardholder check-off information is gathered, cardholder training is essential, and in some cases, the costs of compliance in terms of reduced cardholder productivity outweigh the benefits of a more accurate use tax calculation. In fact, calculation accuracy may actually be reduced if the cardholders are not adequately trained.

Practice 4 can also include Level II information captured by point-of-sale equipment. However, while the accuracy and availability of Level II tax data continues to increase, Level II data may not make a significant contribution to increased tax calculation accuracy until its consistent availability and accuracy are ensured. Additional information on Level II data is available in the question and answer section that follows.

Using this practice in combination with Practices 1, 2, and 3 increases complexity without necessarily significantly increasing accuracy, especially if the practices are not automated. However, the increased availability of accurate Level II data or automated responses from adequately trained cardholders can provide the level of accuracy many companies seek.

Practice 5: Tax Department Line Item Review

Under this practice, tax departments are obligated to perform a line item review in which each transaction is analyzed in order to determine whether sales or use tax should be accrued. Although this practice provides a high level of accuracy, it involves significant time and expense, and it is typically not necessary to pass audit scrutiny.

While an organization will most likely not receive additional value from reviewing all transactions in detail, there may be some limited cases where application of this practice would be particularly beneficial. For example, a detailed transaction review may be worthwhile for accounts with large transaction limits or for large dollar purchases.

Questions & Answers

Q. Should the tax department be brought in at the beginning of the card program implementation process?

A. Definitely. Tax department involvement at the beginning of the process is crucial to the success of a purchasing card program.

The most effective purchasing card sales and use tax accrual process is a single, centralized tax department that manages all sales and use tax issues. Tax departments have the sophistication and understanding needed to enable proper compliance with sales and use tax requirements. Centralizing this function also minimizes the amount of time multiple cardholders spend on sales and tax issues, which, in turn, increases the efficiency of employees. Getting the tax department involved early on allows it to participate in company policy decisions and to be included in initial card program implementation.

It is not good practice to make cardholders solely responsible for tax compliance or to ignore tax issues. Most cardholders do not have the expertise needed to comply with sales and use tax requirements. Making cardholders responsible for compliance also increases the risk of vulnerability during the audit process.

Q. What is Level II data?

A. Level II data is point-of-purchase information.

While the definition of Level II data varies across the industry, it may be generally defined as additional transaction information captured during processing, most often input at the point of purchase. As related to sales and use tax issues, it refers to a process where additional information about the sales tax paid is gathered at the point of purchase, then reported back to the cardholder organization with other transaction details.

The Visa system is programmed to recognize transactions in which both the merchant and the card account are Level II enabled, prompting the merchant to input Level II information about sales tax paid, if any. A maximum of seven digits of data is then transmitted through the card processing system to the card Issuer, for ultimate delivery to the cardholder organization.

To be Level II capable, merchants must use enhanced technology, and while an ever-increasing number of merchants use this technology, a significant number have still not upgraded. Because Level II sales tax information cannot be guaranteed for every transaction, organizations that rely on Level II must still review each transaction to determine if sales tax is reported. Those transactions without Level II information, or those that report tax paid of zero, still require a detailed review to determine if use tax is due, and if so, the amount of tax to accrue.

Q. Does Level II data solve the problem of sales and use tax compliance?

A. No, due to the unavailability and potential inaccuracy of Level II data.

Despite improvements, many transactions still do not include accurate Level II tax information, and, as a result, estimation may still be required for proper use tax accrual.

For example, transactions that do include Level II data may still require estimation since Level II data does not provide the detail needed to track exempt purchases. If a merchant employee inputs zero for the sales tax, it is unclear if the purchase was exempt or if the merchant is not required to collect sales tax in that particular state.

In addition, the accuracy of Level II data cannot be guaranteed since it often relies on the merchant's employees manually inputting the amount of sales tax collected.

Also, the use of Level II data does not enable proper tracking of sales tax collection in situations where a part of the transaction represents a taxable purchase and the remaining portion represents a non-taxable purchase. For example, a \$100 transaction in a state with an 8% tax rate may only show Level II tax paid of \$4. It is unclear if this was an error, or if half of the purchase was for exempt goods.

Q. If Level II does not “solve the problem,” what does?

A. Estimation.

Today's corporations are striving for efficiency and cost reduction. Estimation achieves both goals, yielding a balanced combination of cost versus materiality in the process of sales and use tax compliance.

Q. How does estimation work?

A. Estimation is a dynamic system that automatically examines transaction parameters and can be adjusted to meet individual plan users' needs.

Estimation is an automated system that examines transaction parameters as part of the process of determining use tax accruals. The system does not require point-of-purchase information, nor does it require merchants to upgrade their card acceptance technology. In contrast to the Level II system, estimation can analyze all transactions.

Estimation works by automatically reviewing transaction information either in a stand-alone card system or another financial system. Transaction information is downloaded electronically and is not subject to individual error during the data-entry process. To determine when transactions require use tax accrual, estimation software programs analyze: (a) merchant and purchasing cardholder locations; (b) account codes charged; (c) vendor profiles; and (d) exception reports.

Q. Why does the program analyze vendor and cardholder locations?

A. To accrue tax when vendors and cardholders are located in separate states.

Estimation accrues use tax if the vendor and cardholder are located in different states. In these cases, there is a greater chance that the vendor will not collect sales tax, since the vendor may not have established nexus in the cardholder state and is therefore not required to collect the tax.

Q. Why does the program analyze the account code charged?

A. To check if the account code charged represents a taxable transaction.

The account code charged can indicate the types of goods or services purchased, allowing the cardholder's organization to assess potential use tax implications. For example, a charge to lodging expense would not likely raise sales or use tax concerns, and therefore transactions charged to this account could be excluded from the accrual calculation. However, a charge to the miscellaneous supplies account code could have tax implications, since this account is generally used to purchase tangible personal property subject to sales tax. Account codes can be either cardholder account numbers or financial system account numbers.

Q. Why does the program analyze the vendor profile?

A. To check if the vendor charges sales tax.

Vendor profiles are used to provide additional information about the vendor and the types of products sold in order to further refine the use tax calculation. For example, these profiles can be used to identify merchants who sell exempt goods and services, so that transactions with these vendors can be excluded from the use tax calculation. Vendor profiles can also identify out-of-state merchants who are registered to collect sales tax in the state where the goods are delivered, allowing for exclusion of these transactions as well. While this method can provide a higher level of accuracy, it is also more time consuming than using some of the other practices. Organizations should evaluate the costs of establishing and maintaining vendor profiles against the additional accuracy provided.

Q. What is an exception report?

A. A report that excludes transactions from the automatic estimation process.

Exception reports allow transactions to be reviewed on a line-item basis if a specific threshold of materiality has been met. In other words, at a specified dollar amount, estimation excludes certain transactions from the use tax calculation. After automatic exclusion, transactions are included in a user's exception report. The tax department

then reviews the exception report, and the decision to accrue use tax is made on an individual basis. The threshold of materiality can be set at any dollar amount and is a function of the user's concept of materiality. Therefore, large and small companies can tailor estimation to meet their individual needs, giving plan users a greater degree of comfort and an additional advantage over Level II data in the use tax accrual process.

Q. How accurate is estimation?

A. Estimation is a practical balance between accuracy and the cost of accuracy.

Estimation analyzes parameters, in contrast to Level II, which measures point-of-purchase information. Estimation considers all transactions in the use tax accrual process, rather than just a percentage, and can provide an acceptable level of accuracy when used with proper parameters.

Automated estimation also reduces complexity in the compliance process, relieving the burden of individual line-item review.

In fact, estimation provides a practical approach to cost versus materiality, since the cost to achieve a greater level of comfort can outweigh the benefits of increased accuracy. In other words, the end may no longer justify the means. This is true for both large and small companies. The concept of materiality is relative, and estimation can automatically produce materiality exception reports based on the individual needs of plan users.

Q. Will states accept estimation in an audit?

A. Yes, although organizations should review any changes to their current accounting with the proper authorities.

States will review the level of the accrual and determine its accuracy. In performing the review, states will audit the supporting documentation to verify that the estimates are reasonable.

Q. How can I utilize my company's direct-pay permit?

A. The direct-pay permit allows a company to purchase items tax-free from vendors.

Manufacturers, the majority of whose purchases qualify for a sales tax exemption, most frequently use a direct-pay permit. A company that uses a direct-pay permit in connection with a card program purchases items tax-free from its vendors by issuing its direct-pay certificate. The company is then responsible for accruing use tax on items put to taxable uses. This accrual can still be determined by using an estimation tool.

Q. What if taxable and non-taxable items are purchased together, taxable property and exempt services are purchased together, or a purchase of taxable property is shipped to different locations?

A. The estimation process may over- or under-accrue use tax, or include the transaction on an exception report.

Estimation may utilize either of two methods in these circumstances. Users may exclude transactions from the estimation process and include those transactions in the exception report where tax departments can accrue tax on a line-item basis. Or, the estimation tool can be programmed to over- or under-accrue use tax based on the parameters established by the end-user. After total accrual, the tax figure generated can be adjusted to account for the materiality of over- or under-accrual.

Q. How can we ensure that tax is accrued at the correct rate?

A. Proper estimation set-up.

Programming proper sales and use tax rates into estimation parameters at the beginning of the process ensures that tax is accrued at the correct rate for different states, counties, and cities.

Q. How can we tell if the estimation process has calculated its report based on all purchases made with purchasing cards?

A. Estimation report review.

Retaining copies of estimation reports, including exception reports, allows tax departments to check if estimates have been prepared based on all transactions.

Q. How are items returned to the vendor handled?

A. Estimation report tax credit.

Estimation can automatically download credits for returned merchandise into the estimation computation and present the tax credit as a negative accrual against the total positive accrual on the estimation statement.

Q. Should we retain receipts from the vendor in addition to credit card charge receipts?

A. Yes.

Retaining receipts from vendors in addition to credit card charge receipts allows cardholders to check off receipts on their purchasing card statements to ensure that purchase prices are correct. Receipts are also required to audit cardholder compliance with other corporate policies, such as purchase of prohibited items.

Q. Should we collect all of the receipts from employees who use a card account for procurement?

A. Yes.

Retaining all receipts may be useful for defense during the audit process. In fact, all receipts should be kept at a centralized location after a specified period of time.

Q. How do we know that the employee has collected all of the receipts?

A. Cardholder receipt check-off and random audits.

Establishing two levels of review provides the best method for tracking receipt collection. At the first level, cardholders check off receipts on their card receipt envelope to ensure that purchase prices are correct. In addition, random, rather than systematic, audits of cardholders provide the best incentive for cardholders to manage their receipts properly on an ongoing basis.

Q. I'm using a single card for both travel and purchasing—how does that impact estimation?

A. Travel and entertainment vendors can most often be safely excluded from the use tax accrual calculation.

When charge accounts are used to pay for travel expenses, such as car rentals, hotel rooms, restaurant meals, etc., taxes are collected, since the service is “consumed” in the same state in which it was purchased. Because merchants charge, collect, and remit sales taxes on such travel-related services, use tax is generally not an issue for these expenditures.

As a result, charges to travel-related merchants can be excluded from the use tax accrual calculation in essentially all cases.