# Sales & Use Tax Planning and Reporting for CPAs

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# With You Today

Brent Watson CPA
State & Local Tax Manager
Grant Thornton LLP – Tulsa, OK
(918) 877-0808
(918) 284-8499 cell
brent.watson@us.gt.com

# LEARNING OBJECTIVES

- Have a basic understanding of sales and use taxes so that appropriate *plans* can be made to handle them
- Understand *reporting* responsibilities for sales and use taxes, and basic steps needed to fulfill those duties
- NOTE: Explanations of tax laws in this presentation pertain to Oklahoma. Sales tax laws vary between states and are often quite inconsistent.

# AGENDA

## I) PLANNING FOR SALES & USE TAXES

A. By the Seller

B. By the Purchaser

C. Occasional Sales

## II) REPORTING OF SALES & USE TAXES

A. By the Seller

B. By the Purchaser

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# 1. Sellers must know the taxability of the goods & services that they are selling

While sellers do not need to function as “auditors” it is helpful if they understand the basic sales tax laws that apply to the products and services that they are selling. This would include sale of TPP, services, intangibles, sales to and by contractors, and a general knowledge of exemptions that purchasers (manufacturers, etc.) might be entitled to.

Sellers should also be knowledgeable of taxability of ancillary charges that are added to invoices for items sold.

# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

Taxability of ancillary charges included as separately stated items on invoices:

- Freight – excluded/NT
- Installation – excluded/NT
- Finance charges – excluded/NT
- Discounts – included - net amount is tax base (manufacturer coupons and rebates are excluded and do not reduce the taxable amount)
- “Freight in” and “fabrication” charges are included in the taxable basis of the item being sold.

# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

Treatment of Merchandizers of TPP and Service Providers:

- Sellers of Goods:
  - must collect either tax or exemption certificates in states where nexus exists
  - if selling into other states, need to be aware of changes in business that could create nexus – sales activities, deliveries in company vehicles, repair or installations, etc.

# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

Tax Treatment of Merchandizers of TPP and Service Providers - *continued:*

- Sellers of Services – generally are not required to collect tax on billings, but are liable for tax on purchases. A current controversy is being litigated concerning whether certain service providers can itemize materials and collect tax on them as a retailer would.

# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

- Tax Treatment of Contractors :
  - Contractors are treated as consumers of the TPP that they either incorporate into real property or consume during construction. As such, they must pay tax on the materials they use. Generally, their billings are not taxable.
  - Normally, the exempt status of customers is irrelevant to taxability of contractors' purchases.



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# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

- Tax Treatment of Contractors :
  - Pass-through exemptions are of special importance in OK – as the state has provided pass through status to a long list of taxpayers: including refineries, most state and local governmental agencies and churches
  - Additionally, for a few specific types of exempt taxpayers (including agricultural permit holders, colleges, and rural electrics, possibly gov't agencies, among others), the contractor can also purchase consumable materials used in the project on an exempt basis.

# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

- Tax Treatment of Manufacturers :
  - Purchases – Manufacturers are entitled to a generous exemption of various inputs into the manufacturing process, including utilities, consumables used manufacturing, safety apparel, machinery and equipment, etc. but ONLY IF they obtain an MSEP.
    - The exemption applies to “goods, wares, merchandise, tangible personal property, machinery and equipment sold to a manufacturer for use in a manufacturing operation” (Oklahoma Administrative Code 710:65-13-150.1 and Okla. Stat. 68 §1359[1])



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# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

- Tax Treatment of Manufacturers' Purchases *continued*:
  - Begins where materials enter manufacturing site, and continue through the point where the items leave the site ( 68 O.S. Sec. 1352(15)
  - This is a VERY broad exemption – covers the integrated manufacturing process - includes items like storage racks for materials and goods.
  - Extends to machinery, utilities and chemicals consumed for pollution control





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# 1. Sellers must know the taxability of the goods & services that they are selling – *continued:*

- Tax Treatment of Manufacturers:
  - Sales – Manufacturers must collect tax, or exemption certificates in lieu of tax, like any other retailer.
  - A special exemption applies to sales by an OK manufacturer to an out-of-state purchaser for immediate transportation and usage OOS (Rule 710:65-13-152.1). The seller must obtain an exemption certificate stating that the buyers will be immediately removing the goods for OOS usage.

# 2. Sellers must understand their roles as fiduciaries

- A fiduciary acts as an agent in a trust capacity for another – in the case of sales tax collections or taxes withheld from employees, they act as an agent for the governmental agency that imposes the specific tax

- Failure by “responsible parties” to remit taxes collected from others is considered  to be “conversion” or theft, and can result in personal liability

- “Responsible parties” are generally those who are in a position to chose who to pay and who not to pay

# 3. Sellers must understand how to deal with exempt sales

- If an a good is by default taxable, sellers should collect either sales tax or an exemption certificate
- Failure to collect and maintain valid exemption certificates is the major focus of many sales tax audits and is often the main source of assessments
- Implementing a good plan of obtaining and maintaining valid exemption certificates is probably the single most important step that a seller can take to reduce their audit exposure.

# 4. Sellers must be able to calculate and accumulate taxes to be paid and to track exemption certificates

- Many accounting software packages (even Quickbooks ) have functionality to collect and track sales taxes but often depend on manual input and maintenance of rates.

- For sellers dealing with multiple states and a variety of local sales taxes, it is often advisable to purchase a sales tax software tool, such as AvaTax or Vertex SMB.

- Exemption certificate management programs are sometimes needed and can be a tremendous tool to minimize future audit exposure

# 5. Sellers must understand the consequences of selling into other states ("Nexus")

- Nexus – comes from the same word as 'connection' and for tax purposes means that the taxpayer has enough connection with the taxing jurisdiction to allow the that jurisdiction to impose tax collection or reporting on that party

- Nexus has traditionally required a 'substantial physical presence' in the jurisdiction

- Nexus factors: deliveries in company vehicles, installations, repairs, performance of services, sales calls

# 5. Sellers must understand the consequences of selling into other states - *continued*

- Nexus also applies to “home ruled” jurisdictions separately in AL, AZ, CO, and LA.

- The concept of nexus is being challenged by multiple states that are now seeking to impose tax based on “economic nexus”

- If the US Supreme Court allows this to stand, treatment of remote sellers for sales tax duties will be radically changed almost overnight and will require many decent sized remote sellers to collect in almost every state.

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# 1. Sales Tax Treatment of Purchases: General procedures

Four possible outcomes apply to taxation of a purchase:

- If the *vendor charges* sales tax
  - Pay tax to the vendor as invoiced
  - Claim an exemption by issuing an exemption certificate to the vendor

- If the *vendor does not charge* sales tax
  - Pay the invoice as is and do not accrue use tax
  - Pay the invoice as is and accrue consumer's use tax

# 1. Sales Tax Treatment of Purchases: General procedures – *continued*:

- Purchasers must take steps to be able to calculate and accumulate use taxes to be paid to taxing authorities
- Manual calculation and tracking may be appropriate for small operations
- Software to automate this function can be a wise investment for larger operations

# 1. Sales Tax Treatment of Purchases: General procedures – *continued*:

- Direct Payment Permits ("DPP")
  - A DPP is a special type of use tax permit that certain purchasers can obtain that allows them to make purchases tax free and to instead pay tax directly to the state
  - OK does not limit use of DPPs to certain types of taxpayers (such as manufacturers)

# 1. Sales Tax Treatment of Purchases: General procedures – *continued*:

- Advantages of Direct Payment Permits
  - manufacturers: control of taxability determination
  - oil and gas operators – can result in favorable treatment of local taxes applicable to the transaction
  - multi-state businesses receiving goods that are temporarily stored in OK, then used out-of-state – accrue correct tax and avoid double taxation

# 1. Sales Tax Treatment of Purchases: General procedures – *continued*:

- Disadvantages of Direct Payment Permits
  - Frequent audits
  - Requirement to accrue taxes correctly
    - ✓ Administrative burden
    - ✓ Potential underpayment exposure
  - Those implementing DPPs should consider automation of accruals

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# 2. Sales Tax Treatment of Purchases: Service Providers

- Service providers are consumers of materials that are used or consumed in the provision of a service.

- Certain items that are itemized on repair bills, etc. can be treated as items that are retailed and sold to the customer, for example, automobile parts on a repair bill.

- If vendors do not charge sales tax on materials that are purchased by service providers for any reason other that being resold, the service provider should accrue and remit use tax to the state.

# 2. Sales Tax Treatment of Purchases: Service Providers

- Service providers may need to obtain a consumer use tax account in order to accrue and pay tax on their purchases.

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# 3. Sales Tax Treatment of Purchases: Contractors

- As previously stated, contractors are deemed to be consumers of materials that are used or consumed in the provision of a service.

- Contractors sometimes “wear multiple hats” – functioning both as a contractor, and also as retailer, fabricators or service provider.
- For example:
  - Fencing contractors who also sell fencing materials otc
  - HVAC contractors who fabricate ductwork and sell it to other contractors or the public out of a metal shop.

# 3. Sales Tax Treatment of Purchases: Contractors

- In the case where contractors have a dual function, for tax purposes acting both as a retailer of some goods and the consumer of other goods, they can maintain a tax free inventory (purchased for resale), then use internal invoicing or some other mechanism to accrue and remit sales taxes on good withdrawn from that exempt inventory of taxable usages.
- If vendors do not charge sales tax on materials that are purchased by contractors, for any reason other that being resold, or having a pass-through exemption status, the contractor should accrue and remit use tax to the state.

# 3. Sales Tax Treatment of Purchases: Contractors

- Pass-through exemptions are of special importance in OK – as the state has provided pass through status to a long list of taxpayers: including refineries, most state and local governmental agencies (long list see OAC 710:65-7-13(b)), and churches
- Additionally, for a few specific types of exempt taxpayers (including agricultural permit holders, colleges, rural electrics, and refineries), the contractor can even purchase consumable materials used in the project on an exempt basis

# 3. Sales Tax Treatment of Purchases: Contractors

- In order to document purchases made on an exempt basis based on a pass-through exemption, vendors should require (see OAC 710:65-7-13(c)) that contractors provide the following documentation:
  - A copy of the exemption letter or card issued to one of the entities described in (b) of this Section;
  - Documentation indicating the contractual relationship between the contractor and the entity; and,
  - Certification by the purchaser, on the face of each invoice or sales receipt, setting out the name of the exempt entity and the contract for which the items are purchased

# 3. Sales Tax Treatment of Purchases: Contractors

- Consumer use tax may be due on equipment brought into the state
  - Some states (like TX) have a ‘first use’ test and exemption, but OK does not
  - OK law requires remittance of use tax if the in-state rate is lower that the tax rate paid the state where originally purchased. The taxable basis is the *original cost*. (see Letter Ruling 14-063, 6/24/2015)
  - TIP: Contractors who use large equipment, such as cranes, drilling rigs, etc. should track sales tax paid on each unit. LA parishes present similar sales tax issues.

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# 4. Sales Tax Treatment of Purchases: Manufacturers

- As previously stated, manufacturers are entitled to a generous exemption of various inputs into the manufacturing process, including utilities, consumables used in manufacturing, safety apparel, machinery and equipment, etc. but ONLY IF they obtain an MSEP.

- Manufacturers may need to issue exemption certificates to vendors who sell a mixture of items that qualify and do not qualify for the manufacturing exemption, and then accrue tax on the taxable items.

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# 5.) Exempt Entities

- Purchases by exempt entities should only be granted exemption by the seller if the purchases are made using funds of the exempt entity (credit card or check).

- Misconception: All entities that are exempt from income taxes (for example 501©(3) organizations) are exempt from sales taxes

# Exempt Entities - *continued*

- Many entities that qualify for potential exemption must apply to the OTC and obtain an exemption letter which then be supplied to vendors as proof of an exemption and which will serve as an exemption certificate.

Types of entities which may receive an exemption card or letters certifying or confirming a specific statutory exemption include:

# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption

- Adjudicated Juveniles - Children's Home for [1356(21)]
- Agriculture Exemption [1358; 1358.1]
- Boys and Girls Clubs [1356(20)]
- Boys Scouts [1356(9)]
- Cable Television - Licensed Cable Television Operators [1359(9)]
- Campfire Girls [1356(9)]
- Career Technology Studen Organization [1356(50)]
- Children's Homes Supported by Churches [1356(27)]
- Churches [1356(7)]
- City/County Trusts and Authorities [1356(1) or 60 O.S.§ 176]
- Collection and Distribution Organization [1357(14.a.1)]
- Community Based Health Centers [1356(22d)]

# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption – *cont.*

- Community Based Autonomus Member [1356(57)]
- Community Health Charities [1356(61)]
- County Governments [1356(1)]
- Daughters of the American Revolution
- Disabled American Veterans Department of Oklahoma [1356(28)]
- 100% Disabled Veteran [1357(34)]
- Disadvantage Children - Cultural Organization for [1356(24)]
- Federal Credit Union - Federal Law [Title 12 U.S.C, § 1768]
- Federal Governments [1356(1)]
- Federally Qualified Health Care Facility [1356(22a)]
- Federally Recognized Indian Tribes
- Girl Scouts [1356(9)]

# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption – *cont.*

- Grand River Dam Authority [1356(10)]
- Independent Nonprofit Biomedical Research Foundation [1357(25)]
- Iindependent Nonprofit Community Blood Bank - Headquartered in this state [1357(25)]
- Indigent Health - Clinics receiving funds from the Indigent Health Care Revolving Fund [1356(22c)]
- Meals on Wheels - Organization which provides prepared meals for home consumption to the elderly or homebound [1357(13a) Text as amended by Laws 2006, 2nd Ex. Sess., C. 44, Sect. 5, eff. July 1, 2007.]
- Metropolitan Area Homeless Service Provider [1356(54)]
- Migrant Health Center [1356(22b)]

# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption – *cont.*

- Motion Picture/Television Production Companies [1357(23)]
- Municipal Governments [1356(1)]
- Museums - Accredited by the American Association of Museums [1356(25)]
- National Volunteer Women's Service Organization [1356(62)]
- Oklahoma Coal Mining Companies [1359(13)]
- Older American - Organizations providing nutrition programs for the care and benefit of elderly persons [1357(13b) Text as amended by Laws 2006, 2nd Ex. Sess., C. 44, Sect. 5, eff. July 1, 2007.]
- Private Schools Elementary/Secondary [1356(11)]
- Private Schools Higher Education [1356(11)]
- PTA/PTO Organizations [1356(13a.6)]



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# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption – *cont.*

- Public Schools [1356(13a.1)]
- Qualified Neighborhood Watch Organization [1356(53)]
- Radio/Television - Licensed Radio/Television Station for Broadcasting [1359(8)]
- Rural Electric Coops [18 O.S. § 437.25]
- Rural Water Districts [1356(10)]
- State Governments [1356(1)]
- Veterans of Foreign Wars of the United States, Oklahoma Chapters [1356(64)]
- Volunteer Fire Department [1356.1 - 1356(17)]
- YMCA/YWCA [1356(63)]

# Exempt Entities - entities which must obtain an exemption card or letter from the OTC certifying a specific statutory exemption – *cont.*

- Youth Camps - Supported or Sponsored by Churches [1356(29)]

*NOTE*: Bracketed numbers represent reference to Oklahoma Statutes. All are Title 68 unless otherwise noted.

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# 6.) Sales Tax Treatment of Purchases: Items Temporarily Stored in OK

- OK provides a refund of USE TAX for items temporarily stored in OK for usage out-of-state; However, no sales tax exemption applies, so vendors must collect tax

- OK use tax accrual and remittance is required when items are purchased in state, but the tax is refundable when goods are transferred for usage out of state

# Sales Tax Treatment of Purchases: Items Temporarily Stored in OK

- Correct treatment for items temporarily stored in OK then used out of state, on which OK use tax was accrued = apply for refund and accrue other state's use tax

- Nearly every state allows a credit for sales or use taxes previously paid and legally imposed on goods subject to use tax in their state.

# Sales Tax Treatment of Purchases: Items Temporarily Stored in OK

- Destination states have been disallowing credit for OK use tax because it is refundable.

- If the other state's use tax is not accrued, this creates audit exposure

- Additionally, if the OK use tax is not credited – can result in double taxation – Bonus problem – OK only allows a two year window for refund claims!

# Sales Tax Treatment of Purchases: Items Temporarily Stored in OK

- Solution – use DPP to accrue tax when withdrawn for transport to usage location
  - 2012 law change – DP holders are not required to accrue tax on purchases temporarily stored in OK, but intended for usage in other states

- Alternate Solution – Usage of a Purchasing Company

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# 1. Sellers responsibilities for sales tax reporting on sales of business assets

- OK is one of the few states that does not provide an exemption for occasional sales (sales of TPP - non-trade assets) except for some very limited exceptions:
  - formation of a new corporation or partnership
  - certain business reorganizations
  - liquidation of a corporation or partnership

- Therefore, in OK, sales of non-inventory business assets are NOT generally exempt.

# 1. Sellers responsibilities for sales tax reporting on sales of business assets

- This causes many surprises to companies not based in OK and is costly to all companies making such transactions
- Sellers are primarily responsible for filing a sales tax return to report the sales of business assets
- Identifying the value for which TPP is transferred for is a challenge. PLANNING TIP - PSAs should identify values of TPP

# 1. Sellers responsibilities for sales tax reporting on sales of business assets

- The OTC has embarked on an aggressive campaign recently to check for sales tax reporting of assets shown to be sold on corporate income tax returns – IRS Form 4797

- Historically, the state had only been pursuing oil and gas operators – being triggered by the filing of change-of-operator forms with the OK Corporation Commission. The OCC will later share this information with the OTC, putting the OTC on notice that a sales type transaction has occurred.

# 1. Sellers responsibilities for sales tax reporting on sales of business assets

- The main issue facing oil and gas operators who sell or purchase interest in oil or gas wells is the valuation of the TPP that is included in the price of the well.
- The "21% Rule"
- Alternative methods of valuation

# 1. Sellers responsibilities for sales tax reporting on sales of business assets

- Transfer of assets between partnerships with uncommon ownership is also an issue – mainly affecting oil and gas operators. Example:

Partnership A (with partners 1,2,3, & 4) transfers materials to Partnership B (with partners 1,2,3, & 5) .

In this case, tax would be due on the proportional ownership of Partner 4, who is not an owner in the buying partnership.

# 2. Purchasers liability for sales tax on sales of business assets

- The OTC can pursue either the buyer of the seller for taxes due on sales of TPP – including occasional sales
- Normally, the PSA for a sale of business assets indicates that the purchasers must reimburse the seller for sales tax on sales of business assets
- Purchasers may need to obtain a sales tax permit, manufacturer's sales tax exemption permit, or any other exempt designation BEFORE the purchase in order to issue an exemption permit that is effective as of the date of the transaction.

# Examples of Tax Liability for Occasional Sales

Example 1:

The sale of a restaurant is made. $200,000 of the sales price is attributable to equipment, furniture and fixtures. Tax is due on the $200,000.

# Examples of Tax Liability for Occasional Sales

Example 2:

The sale of a factory is made with the following breakout: $200,000 furniture and fixtures, $800,000 for inventory, and $5M for mfg. equipment.

- Tax is due on the $200,000.
- If the buyer is registered for a MSEP, an exemption certificate can be issued for the inventory and mfg. equipment. If the buyer holds a sales tax permit, the inventory only could be bought tax free for resale. Otherwise, tax will be due on the entire $6M.

# Examples of Tax Liability for Occasional Sales

Example 3:

A group of leases on oil and gas properties is made. While a single price exists, allocation of that price is included in the PSA listing the value of each well, but no other detail is provided

- Tax is due on the TPP – the value of which is an issue
- The OTC's position: they look to either the sales price, or the remaining undepreciated basis as the taxable amount
- OTC has looked at buyer's tax return to see the basis being depreciated

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# Reporting of Sales and Use Taxes by Sellers

- Reporting taxes can become increasingly difficult as the number of state and local jurisdictions increases

- Significant costs can be incurred when returns are missed, taxes are miscalculated and misreported, or filed and paid late

- Investment in reporting software or outsourcing of reporting and paying sales and use tax can be a wise investment



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# Reporting of Sales and Use Taxes by Sellers

- Being ready to produce exemption certificates when required for audits should be considered as part of the reporting function

- Responsible parties can be held personally liable for unreported and unremitted tax

# Reporting of Sales and Use Taxes by Sellers

- A VDA can be effective for taxpayers who owe taxes that need to be reported for prior periods, such as when a taxpayer determines they had nexus and should register for and begin to collect sales taxes as well as remit taxes that should have been collected for prior periods

- The OTC formerly did not allow taxpayers already registered for a tax type to participate in a VDA for that tax type. However, this session HB 2252 has removed this restriction.

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# Reporting of Sales and Use Taxes by Purchasers

- Purchasers must apply for a use tax permit to report taxes
  - Remitting use tax on a sales tax return in OK can result in issues with the OTC. They have asserted that the SOL is not tolled by this reporting since no consumer use tax return was filed.

- Purchasers should know how to deal with overpayments and underpayments of tax on previously made on purchases
  - Refunds from vendors
  - Refunds from OTC

# Reporting of Sales and Use Taxes by Purchasers

- Direct Payment Permits ("DPP")
  - As previously discussed in the planning section, a DPP is a special type of use tax permit that certain purchasers can obtain that allows them to make purchases tax free and to instead pay tax directly to the state

# Reporting of Sales and Use Taxes by Purchasers

- Advantages of Direct Payment Permits
  - manufacturers: control of taxability determination
  - oil and gas operators – accrue tax on point of usage rather than yard where received
  - multi-state businesses receiving goods that are temporarily stored, then used out-of-state – accrue correct tax and avoid double taxation

# Reporting of Sales and Use Taxes by Purchasers

- Disadvantages of Direct Payment Permits
  - Frequent audits
  - Requirement to accrue taxes correctly
    - ✓ Administrative burden
    - ✓ Potential underpayment exposure
  - Those implementing DPPs should consider automation of accruals

# QUESTIONS

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