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Sales Tax Due Diligence (A Deeper Dive)

DUE DILIGENCE , SERVICES FOR PRIVATE EQUITY FIRMS, STATE AND LOCAL TAX
BY

As noted in our previous Our Thoughts On article, sales tax can be complicated in the context of a buying or selling an entity, and proper diligence is necessary to ensure that the buyer is made aware of known liabilities and potentially unknown liabilities. A sales tax due diligence process typically begins with a review of the target company's sales tax returns to determine where the company is currently filing and the tax treatment of its sales.

A review of the target's sales by state is conducted for a period of years to determine where its customers are located and, potentially, where it operates. It is also important to review other available resources including the company's tax policies and procedures and the company's website to gain an understanding of the products or services that the target sells to its customers. A thorough understanding of what the target sells is necessary to determine whether the products or services are taxable in the jurisdictions where it operates.

An interview of the target's personnel or representatives should be conducted to obtain more knowledge of the business and its existing tax processes and procedures. An in-depth understanding of the target's activities across the country is necessary to conclude on where the target has sales tax nexus.

Often, unbeknownst to many companies, sales tax nexus is created simply through:

- sales solicitation within a state,
- product delivery in company-owned vehicles,
- performance of services by employees, or
- storage of inventory.

The interview with the target company's personnel typically includes questions about the company's procedures, including the company's use tax accrual process and which personnel are making taxability determinations. Current and prior sales tax audits should be reviewed to understand the issues raised, tax assessed, and the target's process in place to comply going forward.

Once the analysis is complete, a sales tax due diligence report is generally prepared summarizing any potential issues and estimating the tax exposure. The report includes conclusions as to any weakness in the company's tax processes and procedures, and might include a list of additional states where filing obligations exist.

With the Supreme Court's recent decision in *South Dakota v. Wayfair*, which authorized the states to impose economic nexus on businesses that have $100,000 in sales or 200 separate transactions in a state, nexus issues and tax liabilities will continue to expand for many businesses.

Schneider Downs' due diligence tax advisors assist buyers in assessing the sales tax posture of target companies and the associated risk of potential tax liabilities.

Our advisors recommend corrective action to resolve any issues or liabilities—from obtaining missing exemption certificates to applying for a voluntary disclosure with a state or states.

A voluntary disclosure agreement involves a taxpayer coming forward with notification to a state (typically on an anonymous basis through a third party) that it has a tax liability. In return for the taxpayer's good faith effort to resolve its liability, the state will typically agree to a limited look-back period and in most cases will waive any penalties.

Additionally, many states require that a purchaser (or seller) obtain a tax clearance certificate for an asset sale. If the sale warrants a tax clearance certificate from the state, our advisors can provide an explanation of the process required to obtain the tax clearance certificate from the respective state(s).

Sales tax due diligence can be a matter of "known knowns" or "known unknowns." If conducted properly, the diligence process will affirm the knowns and identify and quantify the unknowns. A buyer that knows where its potential sales and use tax exposure lies is in a better position to act.

Contact our experienced due diligence team to get ahead of sales tax issues that might affect your transactions.

You've heard our thoughts… We'd like to hear yours

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