WHY SHOULD I OUTSOURCE MY SALES TAX?

This white paper is an overview of how small business owners can improve their business performance, lower their costs, reduce their exposure to fines and penalties while meeting important regulatory requirements

Summary

Like any other task within a small business, there are many ways to comply with sales tax filing requirements. This white paper analyzes the benefits of outsourcing to a professional sales tax provider.

Most companies today choose to handle sales tax compliance in house, usually for cost and control purposes. Yet there are several drawbacks to this approach, including lost productivity, rule tracking difficulties, calculation and filing errors, all of which lead to increased exposure, hefty fines and penalties and much time spent on otherwise unnecessary interactions with government bureaucracies.

Outsourced professional sales tax providers give businesses of all sizes and categories, including the small business owner, the convenience and sophistication which until recently were the benefit of large enterprises only. These providers provide secure and accurate sales tax compliance services, at a cost reasonable to even the smallest of businesses.

Ultimately, outsourcing helps management invest more time in what they do best, and in more productive tasks that directly affect the bottom line.

Sales Tax – A Function That Requires Professional Support

Success lies in the details, and so many of the details of establishing and running a small business are not realized by the manager until they need to deal with these tasks in the day-to-day back-office functions of these mundane tasks that are viewed as non-related to business growth. Many of these, like paying the utility bills, are small, and take only a few minutes. Some are more complex and require detail knowledge of areas of expertise beyond the scope of the business manager. Some of these may not take long to perform, and the short time it takes to complete combined with some rudimentary tools lull the business owner into a false sense of security that they are safe, until they realize it is too late.

Sales tax compliance falls squarely into this last category. Most business owners believe that sales tax compliance is a simple process, that falls into the category of paying your electric bill – all it takes is a couple of minutes to complete a simple form, mail it with a check and all is good. They typically do not realize their error until the first notices of assessments begin arriving from the state sales tax agencies, with back taxes owing, as well as hefty fines and penalties.

It Is So Simple – Where Can Sales Tax Compliance Go Wrong?

There are many ways that sales tax compliance can go wrong, especially for the small business owner.

1. Relying On Your Automated System to Seamlessly Handle Sales Tax Calculations

Like all systems, sales tax calculation systems are only as good as the information with which they are programmed. Many programs, like shopping carts and accounting programs, come with what they define to be 'sales tax modules.' Business owners reasonably believe that if they are purchasing an accounting program from a large reliable software vendor, they can rely on all functions performed by that program, including sales tax calculations. What they don't realize is that sales tax functions must be maintained in a variety of ways (these will be covered in more detail in the following sections). The typical accounting programs do not have the subject matter logic and sophistication to accurately deal with sales tax calculations. This non-obvious shortcoming leads many small business owners to falsely believe that they are complying with the rules, only to arrive at a rude wakening when they find out that taxes were calculated incorrectly, and they are on the hook for the difference.

2. Rates must be updated regularly.

The typical automated systems require the user to update sales tax rates. For any given location there could be anything between 3 – 6 different tax rates, including the state; county; city; local and special district rates. Any one of these can change frequently, affecting the taxes that must be collected. If the merchant fails to follow the prevailing rates, and update the rates tables, they will find themselves collecting and reporting incorrect taxes.

3. Applying Taxability Rules.

Different products are taxed differently. Many products have different tax rates (e.g. food; candy; drinks; software); even similar products may have different tax rules (for example – is the candy with or without flour? will determine whether or not the product is taxed as candy). Standard sales tax modules require the user to determine which products are taxed at which rate, and to track the rules how and when they change. These rules are difficult enough for the professionals to track, let alone a small business owner that really wants to focus on growing and maintaining their business.

4. From Whom Should I Collect Sales Tax.

While this is not a big issue for small business owners, most business owners have come across the customer who presented themselves as being exempt from paying sales taxes. There are many reasons for such exemptions, such as when a retailer purchases products for purpose of resale; or the buyer is an exempt organization (such as education or charitable organizations), etc. Tax authorities view these kind of transactions as red flags, and apply strict standards to allow the non-collection of taxes accordingly. The typical accounting and shopping cart programs typically do not have the capability to track this kind of information, and to apply it to the transaction in such a manner that will be accepted by the tax authority.

5. When Should I Collect Sales Tax.

Many merchants are aware of sales tax holidays. The question is when does it occur?, to what products?, and how do I apply it? The problem with sales tax holidays is that often times the decision of the states about whether it will institute a tax holiday, when it will be instituted and on what products, is not made until the very last minute, sometimes only 1 – 2 weeks before the event.

As more states are increasing the sales tax audit teams, and expanding their reach, companies are very quickly finding themselves in very deep water if they have not reviewed and updated the tax rules in their automated system.

6. Inaccurate Completion of Sales Tax Return

Most sales tax returns look simple. They have a few lines of information to enter, calculate the taxes, and voila – the return is complete. What many merchants don't realize is that the different lines are for different kinds of taxes, and entering taxes in the 'sales' tax entry instead of the 'use' tax entry, could result in misfiling of the return. In many states, the business owner also needs to complete the local taxes, breaking down the taxes to different locales and categories. In some states this is made much more complex because the tax is reported according to the place of delivery, not the address of the merchant.

Using an old form, with an out-of-date tax rate could result in the under-reporting of taxes. Forgetting to sign the form will result in the return being rejected, in other words – fines and penalties will be assessed for a late filing (even though you filed on time).

These are just some of the issues that lead to returns being rejected. Once a return is rejected, the sales tax authority will automatically apply fines and penalties, even if the return was originally filed in a timely manner. Even a miscalculation of a few cents could result in hefty fines and penalties.

7. Missing a Filing Deadline

Sales tax returns must be filed promptly, on time, and with all the information intact. The frequency can vary, typically ranging between monthly and quarterly filings. More often than not, the small business owners are focused on their business, and realize too late that they missed the filing deadline. The sales tax authorities are not forgiving. The smallest of infractions, even mailing the return only a day or two late, will result in fines and penalties.

8. Under-Collected Sales Tax

Sales taxes are transaction based. The customer is the ultimate payer of the sales taxes, with the merchant merely acting as a conduit, forwarding the taxes they collected to the tax agencies. What they fail to realize is that once the transaction is completed, they cannot go back to the customer to collect any tax underpayment. So, if it eventually turns out that they under-collected the taxes, the merchant must cover the shortfall out of their own pocket, in addition to the hefty fines and penalties automatically assessed by the states.

Sales Tax OutSourcing – A Method To Avoid These Pitfalls

Sales tax outsourcing is a recommended method for removing the burden from the business owner and overcoming the above described pitfalls. Many business owners perceive that sales tax providers are costly and intrusive. However a closer look will dispel these concerns.

Business owners who outsource their sales tax compliance immediately gain time that they can apply to more productive tasks. Most small business owners did not start the business to spend their time on complying with tax rules, completing and filing tax returns. Employees did not join the business for these purposes as well. By outsourcing these burdensome, mundane tasks, the business owner is not only freeing up time to focus on the business, but also removing a highly dissatisfying task from their repertoire.

Outsourcing allows the business owner to benefit from the talent and expertise of professionals who are expert in the nuances of sales taxes, use taxes, reporting and remitting to the appropriate agencies. They receive the benefit of these services which, until recently, were relegated to large Fortune 500 Companies only.

Professional sales tax providers make the task easy. They typically will automate the process, so that the business owner needs to only manage the process. A good sales tax provider will cut down the tasks so that the business owner will dedicate only a few short minutes each month to sales tax related matters.

The Decision – A Cost Benefit Analysis

Any decision on outsourcing should factor a thorough cost analysis. It is very difficult for the small business owner to put a value on their time. It is therefore difficult to truly assess the cost savings in time alone. However in addition to the time savings, there are tangible expenses associated with sales tax compliance. How much do the checks I use to pay the state cost?; how much does the bank charge me for each check that is cashed by the state against my account?; how much does it cost to mail the return?; how much do I pay a book-keeper / accountant to help with my filing efforts?; how much time is spent on the phone with the tax agencies?; how much did I pay in fines and penalties? Then they should compare these costs, combined with the difficulties and pitfalls outlined throughout this white-paper, with the overall cost of an outsourced sales tax solution.

Modern technologies have enabled sales tax providers to automate and scale the technology so that it is highly affordable, as well as reliable and accurate. Many business owners, even small businesses, will be pleasantly surprised to find out just how affordable a full service sales tax provider is . . .

And the peace of mind – priceless!