



Contractors and the Burden of Sales Tax

Manufacturers - Are You Paying Too Much Sales Tax

Prepared by:

John Fontanella, CPA, CCIFP

The Bonadio Group - CPAs, Consultants & More



January 2017

Contractors and the Burden of Sales Tax; Manufacturers - Are You Paying Too Much Sales Tax, ©2017 Lorman Education Services. All Rights Reserved.

INTRODUCING

Lorman's New Approach to Continuing Education

ALL-ACCESS PASS

The All-Access Pass grants you **UNLIMITED** access to Lorman's ever-growing library of training resources:

- ☑ Unlimited Live Webinars - 120 live webinars added every month
- ☑ Unlimited OnDemand and MP3 Downloads - Over 1,500 courses available
- ☑ Videos - More than 700 available
- ☑ Slide Decks - More than 1700 available
- ☑ White Papers
- ☑ Reports
- ☑ Articles
- ☑ ... and much more!

Join the thousands of other pass-holders that have already trusted us for their professional development by choosing the All-Access Pass.



Get Your All-Access Pass Today!

SAVE 20%

Learn more: www.lorman.com/pass/?s=special20

Use Discount Code Q7014393 and Priority Code 18536 to receive the 20% AAP discount.

*Discount cannot be combined with any other discounts.

Contractors and the Burden of Sales Tax

Contractors have the unusual burden of being considered the consumer of building materials under NYS sales tax law. Because of this, as a general rule, if you are a contractor you must pay sales tax on your purchases of building materials, for both Repairs and Capital Improvements, unless an exemption applies. The most common exemption is the purchase of building materials for tax exempt entities.

This seemingly simple concept can create havoc for the contractor, as it affects your contract bidding, billing your customers, the need to ask for credits and refunds from NYS, and the paying of use tax for out-of-state purchases. The rules are confusing and hard to follow, and often seem counter-intuitive. If sales tax is not handled properly, the contractor can find itself with an unexpected cost that hits the bottom line. No wonder that contractors are a prime target for NYS sales tax audits.

Make no mistake: to cash-hungry tax authorities, your business represents a revenue stream, plain and simple. Their job is to maximize that stream, and a sales and use tax audit is one of their primary tools. In a sales and use tax audit, an auditor reviews your business records over a period of days/weeks/months to determine whether you are underreporting or underpaying taxes that are legally due. In addition to the costly time, effort and diversion of resources this takes on your part, the resulting penalties can be substantial. To you, that's an unexpected hit to your profits; to the state, it's "found money."

Given this kind of return on their efforts, it's no surprise that when states need more funds, they send out more auditors. In short, they're out there looking closer, more aggressively, and with greater frequency than ever before, and the more tax jurisdictions you do business in, the greater the likelihood that you will be audited.

How states determine who to audit

If you know what they are looking for, you can take steps to avoid being audited. But just what are the triggers? Here are the top ten issues that will prompt an audit:

1. Nexus but no registration.
2. Doing business on the phone or on the Web.
3. Issued resale certificates.
4. Use tax auditing.
5. Visual inspections.
6. Whistle-blowers.
7. Casual observation.
8. Non-remission of use tax.
9. High net sales.
10. Exempt items.

Just because you've been selected for a sales and use tax audit doesn't mean you're automatically going to have to pay through the nose. Conversely, just because you've done everything right regarding these taxes doesn't mean you're not going to have to spend considerable time and money proving it.

On average, an auditor spends one week examining records for a sales/use tax audit of a medium-sized company. After examining the records, the auditor will allow you time to gather additional information, if necessary. Follow-up meetings will be scheduled to discuss the overall progress and preliminary conclusions of the audit.

The most common pitfalls

Here are the top ten pitfalls that are most likely to trip you up:

1. Use tax.
2. Exemption and resale certificates.
3. Unreported sales.
4. Charging incorrect rates.
5. History of audits and assessments.
6. Other taxes, such as payroll & excise.
7. Sales tax accruals.
8. Unique rules and regulations.
9. Acquisitions.
10. Business Activity Questionnaires.

The Best Defense is a Good Offense

A cost-effective path to proactive sales and use tax management

There are ways for companies to reduce the risk of being audited, minimize the economic impact of audits, and cut the costs of compliance and defending themselves.

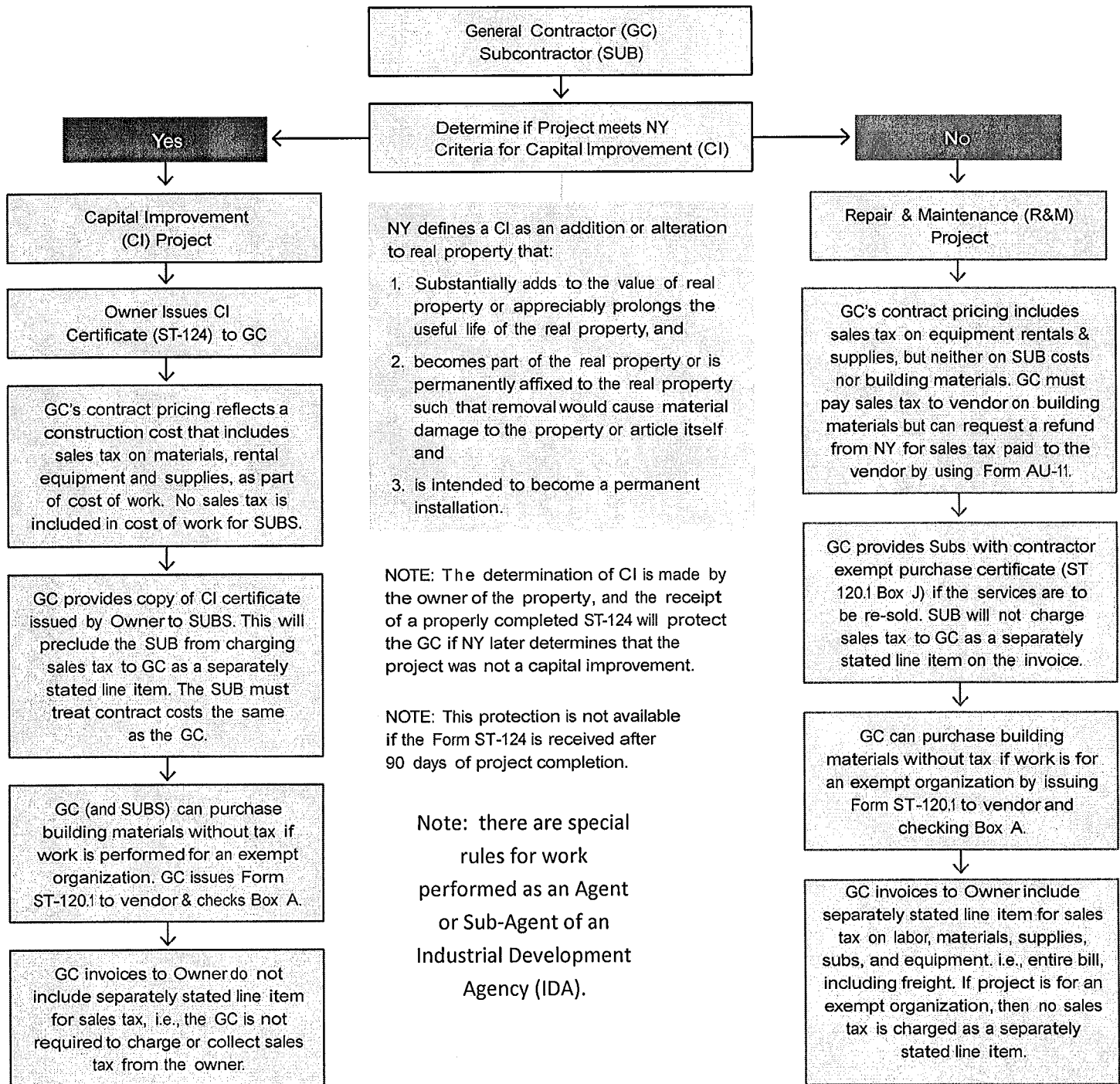
Preparing and simplifying your documentation in advance simplifies and streamlines the audit process, and helps you avoid audit sampling methods that may be to your disadvantage. Understanding the ins and outs of sales and use tax applicability, exemptions and resale certificate usage can keep you out of trouble.

Finally, too often the goal in sales and use tax compliance is focused on making sure that enough tax has been paid. An analysis of sales and use tax procedures may reveal that the company is paying too much tax.

Please contact John Fontanella, Principal with The Bonadio Group, CPAs, Consultants & More, if you would like to discuss further and arrange for an analysis of your sales and use tax procedures.
jfontanella@bonadio.com; (315) 214-2724.

CONTRACTOR SALES TAX FLOW CHART

Prepared by John Fontanella, CPA, CCIFP



Big firm capability. Small firm personality.

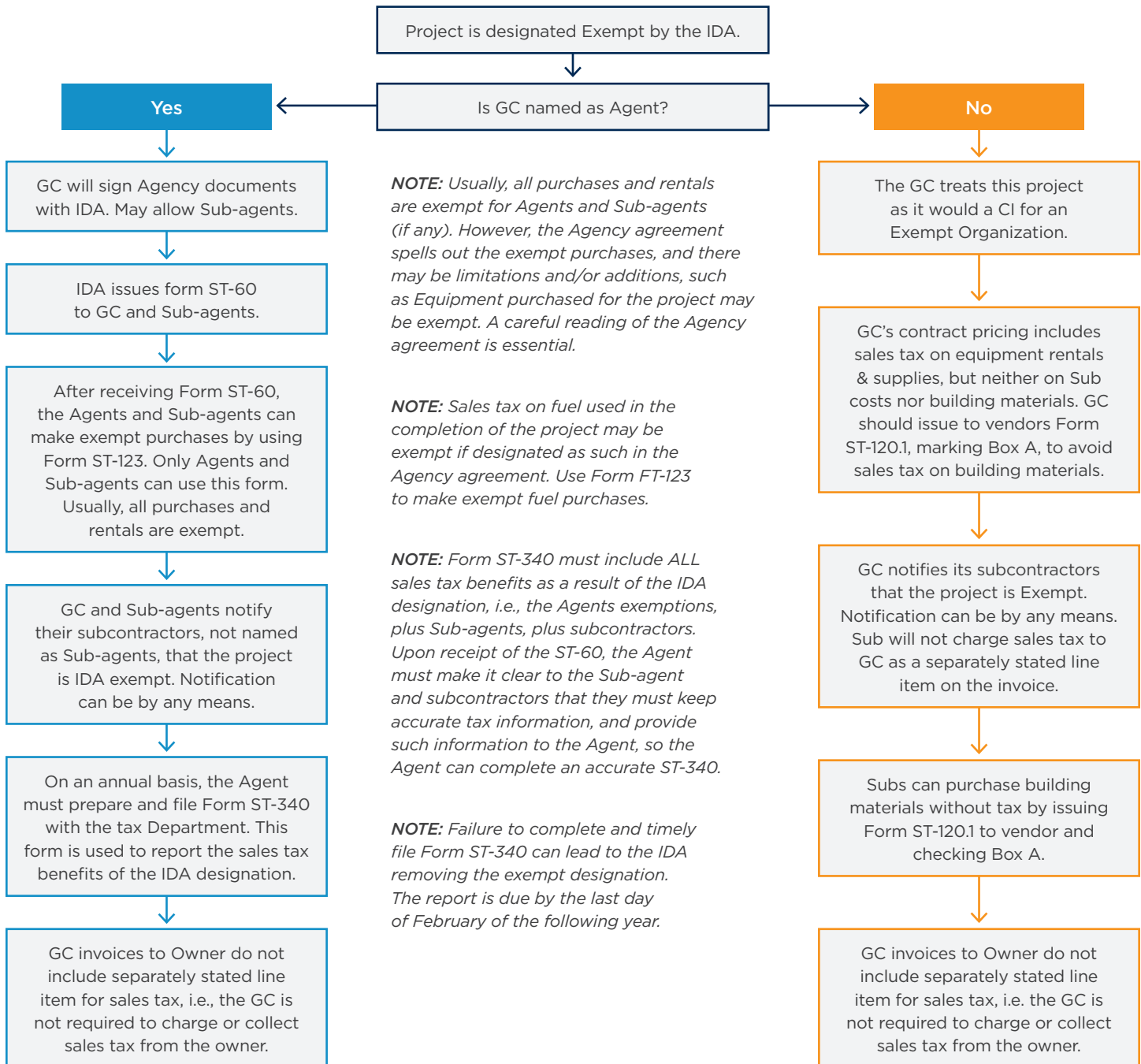
THE BONADIO GROUP
CPAs, Consultants & More

Albany | Batavia | Buffalo | East Aurora | Geneva | New York City | Rochester | Rutland | Syracuse | Utica

facebook.com/TheBonadioGroup | twitter/bonadiogroup | linkedin.com/company/the-bonadio-group

CONTRACTOR IDA SALES TAX FLOWCHART

Prepared by John Fontanella, CPA, CCIFP



Big firm capability. Small firm personality.

THE BONADIO GROUP
CPAs, Consultants & More

CONNECT WITH US: 877.917.3077 | bonadio.com |   

Albany | Batavia | Buffalo | East Aurora | Geneva | New York City | Rochester | Rutland | Syracuse | Utica

Manufacturers: Are you paying too much sales tax?

New York State's sales tax law provides Manufacturers with **The Production Exemption (the Exemption)**. The Exemption applies when products are produced for sale by the following methods: manufacturing, processing, generating, assembling, refining, mining, and extracting. So, if you produce tangible personal property, gas, electricity, or steam for sale, the Exemption applies to you.

Covered by the Exemption are the following items utilized in the **Production Process**:

- machinery and equipment (including on-site installation and rigging)
- tools
- parts
- supplies
- raw materials

What is the Production Process?

The Production Process (Production) is the means by which products are created. Items that are used or consumed in Production qualify for the Exemption. A manufacturer should identify when Production begins and when it ends. Why? Machinery and equipment used before Production begins or after Production ends, are not exempt, e.g. a forklift that moves finished product from assembly to the warehouse or shipping, but never actually used directly in the assembly, is not exempt from NYS sales tax.

Many items of machinery, equipment, and tools are used partially in Production and partially in other functions. The Exemption applies to these items if they are used directly and predominately (more than 50 percent of the time) in Production.

What other purchases are covered by the Exemption?

Here are some items that may qualify for the Exemption, but are **often overlooked** by manufacturers:

- Installing, repairing, maintaining or servicing production machinery, equipment, parts and tools
- Energy used in Production
- Research and development costs
- Cartons, containers and other packaging materials
- Labels and tags
- Machinery and equipment used in QC
- Waste treatment equipment
- Pollution control equipment
- Safety apparel and safety supplies
- Storage charges
- Food processing equipment
- Process piping

Which New York State forms should I use?

Form ST-121 should be used to purchase property and services covered by the Exemption.

Motor fuel and diesel motor fuel cannot be purchased without sales tax, but the Exemption does apply. Therefore, if used in Production a refund or credit must be applied for, by using Form FT-500.

How do I apply for a refund?

If you have paid too much sales tax because you did not take full advantage of the Exemption, you can apply for a refund or a credit from NYS utilizing Form AU-11 (except motor fuel, which requires Form FT-500). You can file for a refund within three years from the date the tax was payable to NYS.

The most common refund for manufacturers is from sales tax paid on electrical power used in Production. This can be done with an analysis of the kWh consumed by production machinery vs. the company's total consumption. See attached Appendix A from NY Publication 852.

Will applying for refunds trigger an audit?

I have assisted many taxpayers in refund claims, and I've seen very few audits as a direct result of the claim. With that said, you are never safe from an audit. If you have a legitimate refund claim, however, and your sales tax procedures are sound, then the fear of an audit should not keep you from claiming what is rightfully yours.

Finally, too often the goal in sales and use tax compliance is focused on making sure that enough tax has been paid. An analysis of sales and use tax procedures may reveal that the company is paying too much tax.

Please contact John Fontanella with The Bonadio Group, CPAs, Consultants & More at 1-315-214-2724 if you would like an analysis of your sales and use tax procedures. E-mail: jfontanella@bonadio.com

About the Author

John M. Fontanella, CPA, CCIFP, is a principal in Bonadio's Syracuse office. He has more than 30 years of experience offering technical advisory services in taxation. John's experience includes federal, multi-state and international income taxes, specializing in tax planning for manufacturers. He is an expert in sales tax, advising manufacturers, contractors, engineers, and dealerships, including public and international companies. He is a member of the Manufacturers Association of CNY, Contractors Financial Managers Association, and Associated Building Contractors.

