

Anatomy of a Sales Tax VDA: Organizing and strategizing a multi-state Sales Tax Voluntary compliance project

By Raymond Chang, CPA

(Part 3 of 3)

In part one of this series, we examined the initial steps in tackling a comprehensive review of a client's potential exposures to sales tax requirements to states in which they have conducted business.

In part two, we utilized and categorized client-side sales records to lay the groundwork for executing multi-state VDAs for our client. Here, we will walk through the process of executing the first such VDA and the lessons we learned in doing so.

As previously noted, Texas was our first VDA in this project. As one of our Tier I states, the fact that Texas required the greatest level of detail in its VDA submission package also made it a good place to start.

Ready – Set – Go Texas

The first step for our client was to make sure that all exempt sales to customers with shipment to Texas were supported by their appropriate exemption certificates. Using the Sales-by-State-by-Customer schedule (discussed in Part 2 of the series), our client drafted a letter which was emailed to all the respective Texas customers requesting not only their Texas resale certificates but all other states to which orders were placed and shipped. This would prove useful for the VDAs of other states later on. After all the information was compiled, final tallies were summarized and everyone was comfortable with the overall coverage, the next step was to initiate the VDA process and contact Texas.



Before contacting the state, the first thing we needed to do was to draft a fact pattern letter that was consistent with our client's business and their understanding about having Nexus in the state. This letter explains in detail why our client (anonymously referred to) believes they have Nexus and that under these circumstances would request

a VDA. The state would respond with either a "yay" or "nay" to the VDA based on the fact pattern described in the letter.

In the time between the letter being sent to Texas and a response received from the state, we helped our client get the following in order:

- Began accumulating the current sales for the most recent look-back period as stipulated by Texas and then compile a VDA submission file. The file's detail and format vary by state but Texas requires it by invoice and by the applicable localities within the state and their applicable state and local sales tax rates.
- Began sending notification letters to their customers who were shipping to Texas that the company will soon begin charging sales tax unless they are provided with the appropriate resale certificates.
- Engaged and began working with one of the sales tax servicers to prepare the periodic filing once the VDA was approved and the state registration number was received. In conjunction with engaging the servicer, our client also had to make sure their system could be properly integrated with the servicer's.

Once we received the response letter from Texas, there would be a short window to pay the back taxes and start filing the sales tax returns. This prep work gave us a leg up on that process.

One state down, many more to go

After Texas, we went back to the completed Sales by State by Customer schedule and looked at the rest of the Tier I states (states with the greatest exposure). Everything we did for Texas, we repeated for the rest of the Tier I states, then Tier II states and so on.

Once the research and update process was complete, the VDA process began again. However, now that we were doing multiple states, we started with the cleanest ones first while our client's sales team continued to follow up on the exceptions. A word to the wise: on a big project like this, don't initiate the VDA for too many states at one time. Three states at a time was the magic number for us; given the amount of work that goes into each VDA (and the short turnaround required by states once the process begins), it helped to ease management of the process and the exhaustive impact to the client resources.

What we learned from this project

Collaboration was key. It was extremely helpful and important to develop a partnership with our client to pave the path for a viable approach in the long process. This close relationship also ensured that we could react together to the constant refinements that inevitably needed to be made as the process went on.

Since we knew that our client's exposure was significant, we had to spend the time and resources so that it was done right. As such, the value of proper planning cannot be understated. Here's a general time frame:

- The initial introduction, research and deep dive study of the system took months to complete.
- The first VDA with Texas took several weeks to complete (from datafile to VDA to paying the back taxes). This is in part because we wanted to learn as much as possible from the issues that came up; there was also a lot of back and forth with the state.
- Leveraging what we learned from the process with Texas, each state thereafter took less time (each one still took a few weeks, though). The back and forth with the state agents accounted for a large part of that time frame.

One of the most interesting things learned from going through the VDA was the "gap" period (the period between date the fact pattern letter was received by the state and the first day the company could actually start collecting sales tax). Unfortunately, the company was still liable for sales tax during that gap period. Therefore, the back taxes owed under a VDA can add up to be more since the look-back period could be a few months more than the statutory period.

In the end, our client ended up owing less sales tax under the VDA because the actual exempt sales were more than anticipated. Sales that were thought to be for end-use were, in fact, for resale and the customer even provided the resale certificate since they would be charged sales tax if they didn't.

Additionally, we all took from the process the peace of mind that our client could continue doing business in the markets they've been operating in while complying with local laws and regulations. Our client is also better aware and has a better respect for how their business development activities may trigger nexus in new territories in the future.

About Raymond Chang, CPA

As a Senior Audit Manager with more than 15 years of industry experience, Raymond's practice focuses on providing assurance and advisory services to privately-and publicly-held clients in the middle market. He is particularly skilled at working with companies in the manufacturing, distribution and real estate sectors.

Highly analytical, Raymond is skilled at analyzing extensive data and identifying areas for improvement. He enjoys working with clients to find solutions to their problems and advises them in all aspects of business and financial management, including operational and internal control matters and financing. He is involved in the planning and supervision of various corporate, partnership and individual tax returns.

Raymond is a member of the Chinese American Society of CPAs and an active member of the firm's Best Practices and CPE committees. He often takes a leadership role in many of the firm's training and staff development programs. Raymond graduated from St. John's University with a Bachelor of Science degree in Accounting. Raymond can be reached at rchang@mwellp.com.