



Challenging Texas Audits 2018

This teaching manual/outline provides information on general tax issues and is not intended to provide advice on any specific legal matter or factual situation. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. Readers should not act upon this information without seeking professional counsel.

Instructor



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Mrs. Ahlrich has been named a Rising Star in Business Tax by Texas Super Lawyers for 2017 and 2018. This designation is awarded to the top up-and-coming Texas attorneys who are age 40 or younger or have been in practice for 10 years or less. No more than 2.5% of Texas attorneys are chosen for this honor, which is based upon nominations by members of the elite Texas Super Lawyers list.

Notable trial and appellate cases include:

- *Hegar v. Gulf Copper and Manufacturing Corporation*, 535 S.W.3d 1 (Tex. App.—Austin 2017, pet. filed), reh’g denied (Sept. 21, 2017);
- *Hegar v. CGG Veritas Services (U.S.), Inc.*, No. 03-14-00713-CV, 2016 Tex. App. LEXIS 2439 (Tex. App.—Austin Mar. 9, 2016, pet. withdrawn);
- *Titan Transportation, LP v. Combs*, 433 S.W.3d 625 (Tex. App.—Austin 2014, pet. denied);
- *Combs v. Newpark Resources, Inc.*, 422 S.W.3d 46 (Tex. App.—Austin 2013, no pet.);
- *Pointsmith Point-of-Purchase Management Services, LP v. Hegar*, No. D-1-GN-11-001514 (200th Judicial Dist. Ct., Travis County, Jan. 10, 2019); and
- *Garriott v. Combs*, No. D-1-GN-12-003034 (201st Dist. Ct., Travis County, Tex. Oct. 1, 2013).

Mrs. Ahlrich frequently writes and speaks on a variety of Texas tax subjects, including the Texas sales & use and franchise taxes. She holds dual bachelor degrees with honors from the University of Texas and a J.D. from Baylor Law School.

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Strategies in Handling and Challenging Texas Audits

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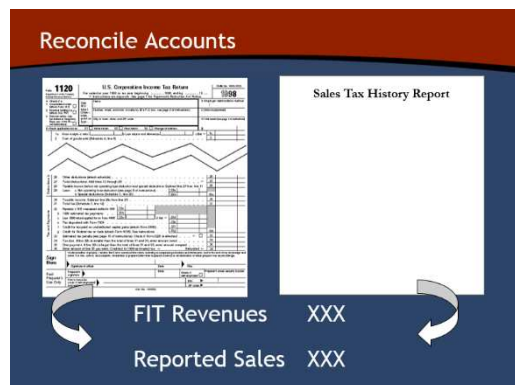
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Chapter I. Before the Audit Begins

Taxpayers will receive a letter from the auditor about six weeks prior to the start of audit field work. It's critical to successfully defending an audit that the CPA undertake the following work:

Reconciling Records

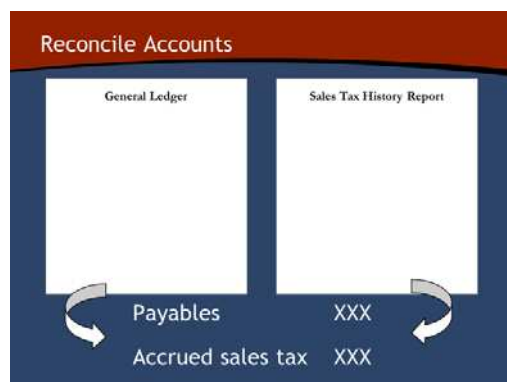
Sales tax auditors will routinely review records of sales, expenses and fixed asset purchases to determine whether a taxpayer owes additional sales tax. Franchise tax auditors will compare the amounts shown on the Texas franchise tax report with the amounts recorded in the general ledger and reported on the federal tax return to determine if additional tax is owed. Therefore, you'll want to assist your clients with examining each of these areas, identifying issues, and clearing up any potential problems before your client receives an audit notice from the Comptroller.



Sales Tax Reconciliation. The Comptroller's auditors compare the total sales reported to the Comptroller with the sales recorded in the taxpayer's books and records and reported on its federal tax return. They also review the sales tax recorded in the general ledger and compare it with the tax remitted to the Comptroller's

office. Any unreconciled difference is normally classified as a taxable error.

Taxpayers should periodically reconcile their sales tax records with the general ledger. At the end of the year, they should compare the reported sales per the sales tax returns with the gross sales reported on the federal income tax return. Having sales tax reconciliation worksheets available for the auditor to review helps to prevent this audit issue from arising.



Sales Tax Collected v. Remitted. Auditors compare records of sales tax collected with the amounts remitted to the state. Each time your client prepares a sales tax report, advise them to enter the amounts into a worksheet that reconciles the sales tax collected (per the general ledger) with the sales tax remitted (per the sales tax return). Advise them to

retain the payment reconciliation worksheets for the auditor's review.

Franchise Tax Reconciliation. Franchise tax auditors typically compare the amounts reported on a corporation's Texas franchise tax returns with the amounts reported on its federal income tax returns and recorded in its general ledger. Advise your clients to prepare reconciliation worksheets each time they prepare their annual Texas franchise tax returns. Have the franchise tax reconciliation worksheets available for the auditor's review.

Resale and Exemption Certificates

Taxpayers bear the burden of proving sales and use tax exemptions. Advise your clients to periodically review resale and exemption certificates. Once your client receives an audit notice, immediately advise them to start gathering any resale or exemption certificates they may be lacking. If your client has the time and the resources, perform a pre-audit or a simultaneous reverse audit to identify and remedy potential areas of contention.

Presumptions. The tax law presumes that all retail sales or uses of tangible personal property are taxable transactions. Contrast this with the performance of taxable services where this presumption does not lie.

In an audit, all of a seller's receipts are presumed to be subject to sales tax unless the buyer furnishes the seller with a properly completed exemption or resale certificate. A resale certificate is appropriate when a purchaser buys a taxable item for the purpose of reselling it. An exemption certificate is appropriate when the purchaser buys an otherwise taxable item for an exempt entity (e.g., government or charity) or an exempt use (e.g., manufacturing or farming). The sale of a taxable item by a person for delivery in Texas is presumed to be a sale for storage, use or consumption in Texas unless the seller accepts an exemption or resale certificate. The purchaser has the burden to claim the exemption to which he or she may be entitled.

Exemption Certificate File. Resale and exemption certificates are the only acceptable proof to support sales for resale or for an exempt use (e.g., manufacturing or farming). Advise your clients to maintain alphabetical files of exemption certificates that will be easy to review prior to the audit. Be sure to save electronic copies in PDF form. Periodically review the file to make sure it is complete. Prior to an audit, advise your client to follow the procedures outlined in the checklist in **Appendix A** to obtain any additional exemption certificates needed to complete the file.

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