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Recoup sales and use taxes

Reverse Audits Ensure You've Claimed Appropriate Exemptions

In an economy where there's no room for unnecessary expenditures or costly mistakes, many manufacturers are turning to the reverse audit to make sure they haven't overpaid sales and use taxes.

Why you may be overpaying

In most states, manufacturers are exempt from sales tax on equipment used in manufacturing or recycling, and many states don't require them to pay taxes on the utilities and chemicals they use, either. In some states, custom software, computers and peripherals are exempt if they're used for research and development projects.

With most state sales taxes now between 4% and 7%, it's worthwhile to be sure you're receiving all the exemptions to which you're entitled. And unless you're diligent about claiming exemptions, you're probably missing out on some.

Most manufacturers have sales and use tax compliance systems to guard against paying too much, but if you haven't reviewed yours recently, it may be functioning improperly. Employee turnover, business expansion or downsizing, and simple mistakes all can take their toll on sales and use tax compliance policies, and you may be paying more than you should.

Reverse audits can go way back

A reverse audit should include an examination of your tax compliance systems as well as your purchasing records. For example, your accounts payable department may be tasked with spotting exemptions that purchasing hasn't requested, but are they doing it?

The audit should extend across your business, going back as far as the statute of limitations on state tax reviews. If your state sales tax auditors can review all records for the four years preceding the audit, for example, your reverse audit should encompass the same timeframe.

Timing is everything

A good time to consider a reverse audit is when state tax laws change. Sales and use tax exemptions typically don't apply to local taxes, and changes in state regulations may be easy for your staff to overlook at first. If a state in which you do business has revamped its tax laws, use a reverse audit to be sure you're not missing additional opportunities for tax savings. Your tax advisor can help you stay up to date on tax law changes.

In the current economy, you may not be undertaking any major capital projects, such as adding manufacturing space. But, when you do, it will be an excellent time to conduct a reverse sales and use tax audit. Even if you can't justify a full, companywide audit because of time or staffing constraints, you can audit transactions associated with the project. During

a capital project is when you'll be buying equipment and supplies that are most likely to qualify for tax exemptions. If you can spot overpayments during the process, you can act to resolve them promptly.

Overpayments can happen anywhere

What types of payments should be reviewed? You may have made sales tax overpayments on components of your manufactured products as well as on the equipment you use to make the products. Other areas where overpayments may occur, depending on state laws, include warehouse equipment, software licenses, safety equipment, maintenance fees and so forth.

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When considering whether you may have overpaid taxes in these and other areas, a clear understanding of your operations is key. You must know where your manufacturing process begins and ends, for example, if you want to ensure

you're receiving maximum benefit from industrial processing exemptions.

Also remember that, if you have plants or sales offices in more than one city or state, your sales tax records may be decentralized. Don't overlook any sites.

Database software can help

Thanks to advances in technology, database software is available to help identify where overpayment is most likely to occur. Select random samples of invoices for review and use the results to project total overpayments.

In some states, such statistical sampling is an accepted method for projecting overpayments. In others, you'll be required to complete a detailed review of all purchases. So before beginning a reverse audit, it's important to understand sampling requirements and tax exemptions for every state in which you do business.

Findings pinpoint weaknesses

Your external sales tax auditor generally will provide you with a written report when the audit is completed. In addition to helping save you tax dollars right away, the findings can be used to pinpoint weaknesses in your compliance system for future tax savings.



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Is “IFRS Light” Right for You?

Small and midsize manufacturing firms should consider whether converting to International Financial Reporting Standards (IFRS) in their financial reports is to their advantage. Private companies can use the simplified 230-page version, IFRS for SMEs (small and midsize entities), released last July by the International Accounting Standards Board (IASB). The full-length IFRS, which is aimed at public companies and used in about 100 countries (but generally not in the United States yet), weighs in at about 2,500 pages.

Less complex, more relevant

IFRS for SMEs, which is frequently referred to as “IFRS light,” lays out a system for accounting and financial reporting that could replace U.S. Generally Accepted Accounting Principles (GAAP). Many of the principles in the full IFRS for recognizing and measuring assets, liabilities, income and expenses have been simplified. Topics not relevant to SMEs have been omitted, and the number of required disclosures has been greatly reduced.

Some CPAs believe that a switch from GAAP to IFRS will take a cultural adjustment because the change in approach is vast. GAAP is based on complex, industry-specific rules and exceptions; IFRS is based on principles, allowing CPAs greater leeway to exercise professional judgment.

For example, the capitalization of leases under IFRS would be based on “substance over form” rather than on specific rules, as is the case under GAAP. Also, the last-in, first out (LIFO) inventory accounting method is not allowed under IFRS.

Benefits over GAAP

IFRS for SMEs is considered to be beneficial to entities attempting to procure international investors. But some accountants say that converting to IFRS might be detrimental to domestic companies until the standards are more well known, because most U.S. lenders are more comfortable with GAAP-based financial statements.

Consider whether converting to International Financial Reporting Standards (IFRS) in your financial reports is to your advantage.

On the other hand, the AICPA has said that private companies may find IFRS for SMEs to be more relevant and less costly to use than GAAP. That echoes the IASB’s sentiment: It’s gone on record as saying IFRS for

SMEs is a response to “strong international demand from both developed and emerging economies for a rigorous and common set of accounting standards for smaller and medium-sized businesses that is much simpler than full IFRSs.”

Ask for advice

Small and midsize private firms should consult with their accountant about whether converting to IFRS light will be advantageous and when such a conversion in financial reporting should be made.



Manufacturing Practice Leaders

At **HMWC CPAs & Business Advisors**, we develop and implement effective solutions for your company’s business concerns. Our Manufacturing Practice is headed by HMWC partners Jeffrey Hipshman and Curtis Campbell.



Mr. Hipshman specializes in family wealth planning for the high net worth individual, as well as business and tax planning for closely held manufacturing and distribution businesses. Jeff frequently lectures on estate planning and is considered a resource for various periodicals and television programs.

Mr. Campbell heads the firm’s Tax Services department. He specializes in all aspects of federal and state taxation for privately-held manufacturing and distribution corporations and their owners. Businesses range in size from start-ups to larger companies with multi-state and international activity. In 1996, Curtis received his Master of Taxation from Golden Gate University.



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