

TEXAS STATE TAX AUDIT

How to Prepare for the Entrance Conference



TEXAS TAX GROUP

OUR TEAM OF FORMER TEXAS COMPTROLLER
STATE TAX AUDITORS IS YOUR BEST DEFENSE

PREPARATION IS KEY



“By failing to prepare, you are preparing to fail.”

—Benjamin Franklin

THE DREADED AUDIT NOTIFICATION LETTER . . . when it arrives it can be the start of a long, complicated and costly endeavor. However, it doesn't have to be that way. The key to surviving a Texas state tax audit is not to sit back and wait, but to prepare . . .

Read on for a step-by-step guide to help you prepare for Day 1 of the audit—also known as the Entrance Conference.

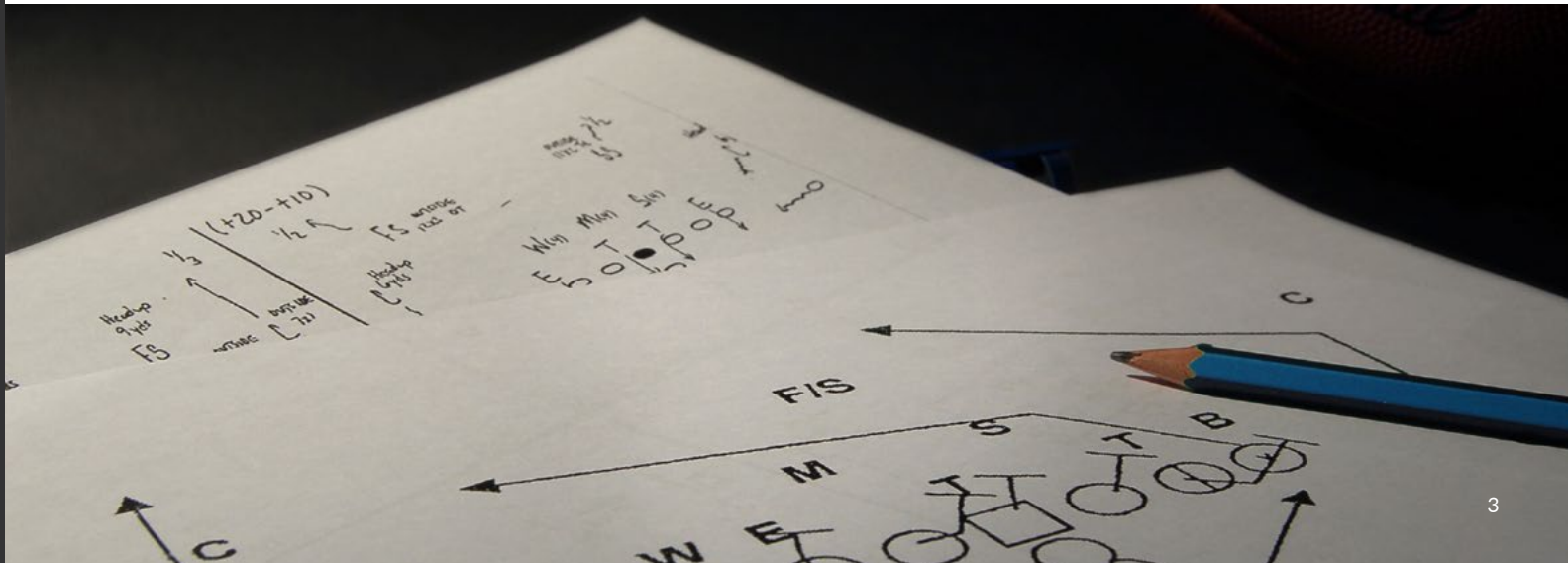


DEVELOP AN AUDIT GAME PLAN

The best defense
is a good offense.

Begin by asking the auditor for a month delay (or more) before setting the Entrance Conference date. Then take that extra time to organize and verify the completeness of your records and conduct a Pre-Audit Review of your sales and purchases for the 4-year audit period. Put together a list of action items that will force you to analyze your sales and purchases for correct taxability.

By anticipating taxability issues and record requests from the auditor, you can help limit the length of time that the audit will take (the average 'tax due' audit takes about 6 months). The rule of thumb is the shorter the audit the less the assessment, if any.



KNOW WHAT TO EXPECT

The Entrance Conference is usually the first face-to-face meeting between you and/or your representative and the auditor. By knowing what to expect and planning for your first contact with the auditor, you will have a better handle on your situation and what you are up against.

During the Entrance Conference the auditor should make you aware of the purpose of the audit, what is expected of you and what to expect from the auditor.



Topics typically discussed at the entrance conference are:

- Tax to be audited (Sales Tax, Mixed Beverage Tax, Franchise Tax, etc.)
- The audit period (usually 4 years)
- Business description, activities and structure
- Accounting system and reporting activity
- Types of customers
- Return preparation, personnel, records used and any changes
- Availability and location of records
- Official Records Request document

GATHER AND ORGANIZE RECORDS

Proper and well-organized records are critical for a smooth audit. Without them, it is impossible for you to defend your actions or prove your case. In addition, missing or incomplete records allow the auditor to estimate tax due, and even add penalties. Here are the most common records requested during an audit:

- Invoices
- Financial statements
- Asset listings
- Chart of accounts
- Customer lists
- Purchase and sales invoices
- Contracts
- Bank statements
- Resale and exemption certificates
- Depreciation schedules
- Federal tax returns
- Sales and use tax returns/worksheets
 - Sales tax payable detail
 - Certificates



PERFORM A PRE-AUDIT EXAMINATION

(Self-Audit)

A pre-audit examination is a self-review of records and procedures, and includes determining if sales tax is being applied to all sales and/or purchases for the 4-year audit period. If certificates are required for certain sales, then these must be on file and facially complete to be accepted by the auditor.

Conducting your own pre-audit gives you an opportunity to: (1) organize your records, (2) check for the completeness of records and (3) determine proper taxability before the auditor begins his/her work. Once the auditor begins it is often too late or difficult to address avoidable problem areas. The result could be an overassessment of tax.

Auditors are primarily looking for three things: sales that should have been taxed, tax collected and not remitted (possible fraud) and purchases that should have had tax paid on them. The precise scope of the audit can vary widely based on the business and/or industry and type of tax; however, here are a few of the most common audit issues that you should focus on during your pre-audit examination:



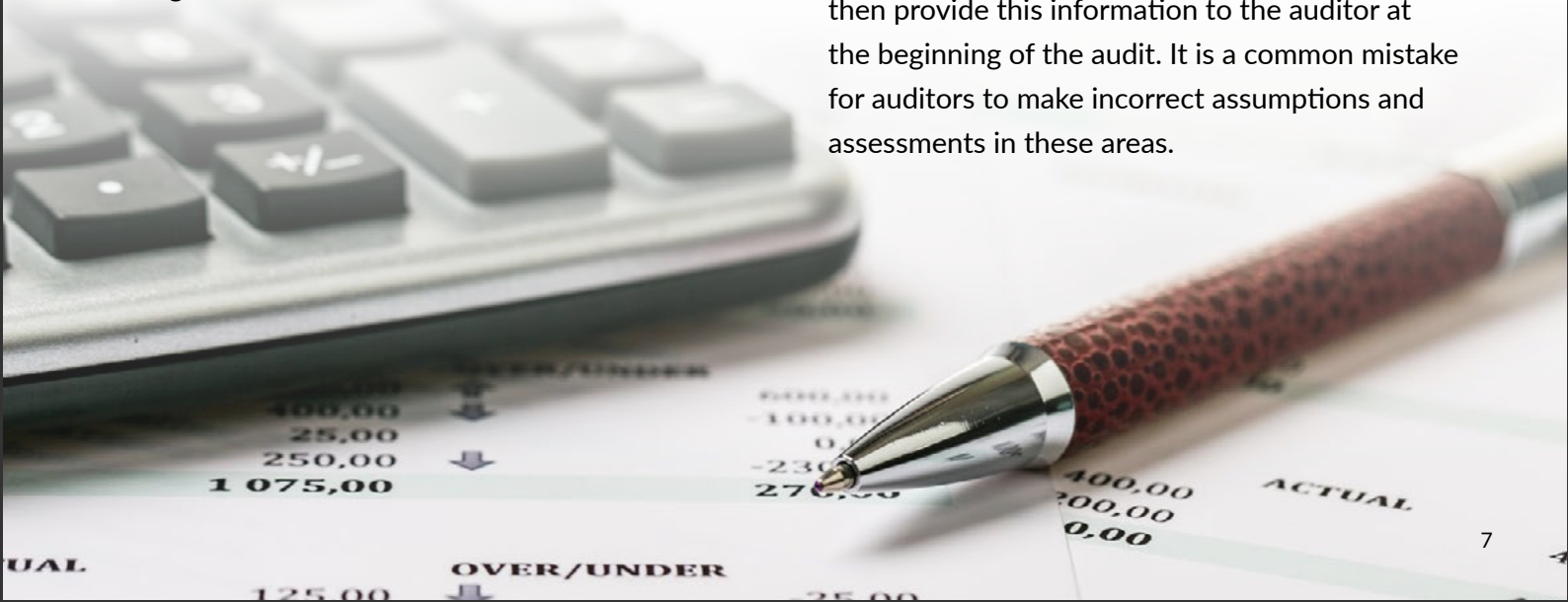
- Misinterpretation of taxability
- Missing exemption and/or resales certificates for untaxed sales
- Incorrect tax assessed based on the type of item sold
- Sales tax collected and not remitted
- Use tax not accrued on taxable purchases
- Missing documentation for non-taxable purchases
- Incorrectly reported tax
- Local jurisdiction tax errors

CONDUCT A GROSS SALES AND SALES TAX RECONCILIATION

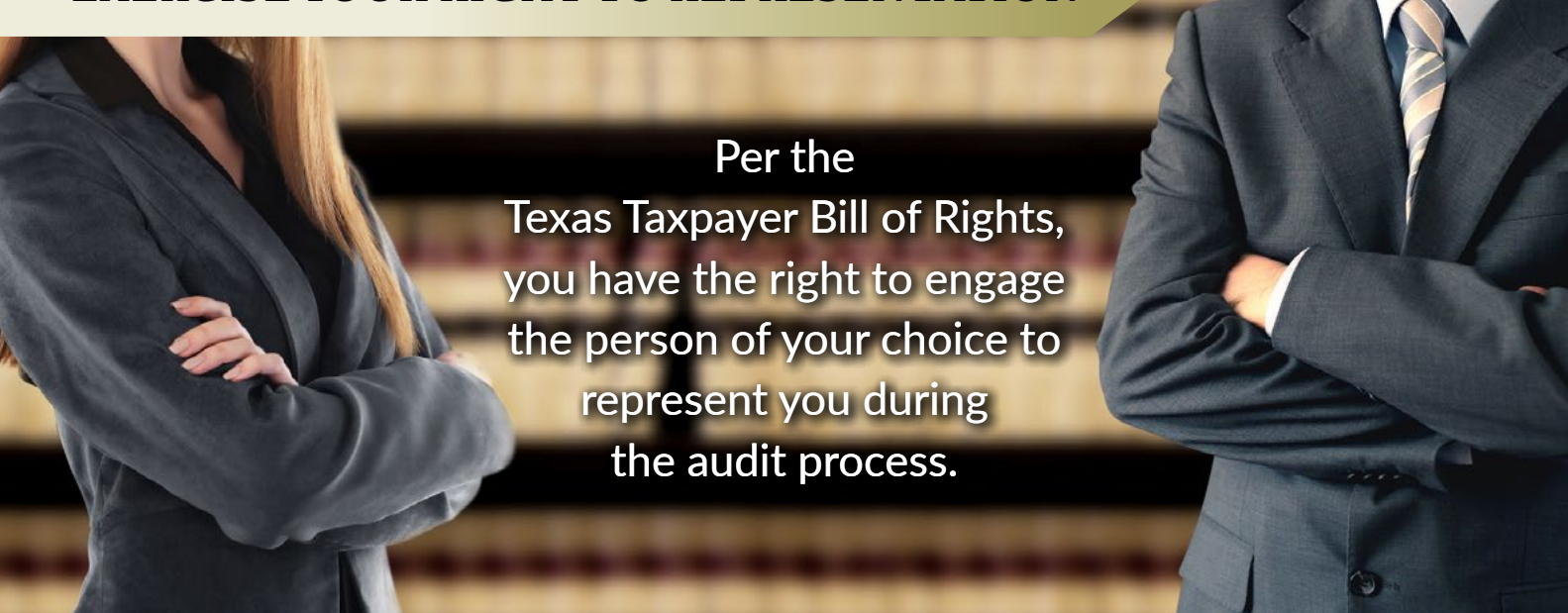
The auditor will compare the gross sales reported with the bank deposits, financial statements and tax returns. If discrepancies are found (i.e., revenue higher than report sales), you will be asked to explain the difference or prove the additional sales are non-taxable. If you are unable to do so, the auditor can easily assess tax on these unreconciled sales amounts resulting in an overassessment of sales tax.

A Sales Tax Reconciliation should be done on either a cash or accrual basis depending on how you report sales tax collected. You must be certain the auditor is aware of all procedures used in reporting sales tax so that no incorrect sales tax is assessed.

It is always best to reconcile gross sales and tax collected during your pre-audit preparation and then provide this information to the auditor at the beginning of the audit. It is a common mistake for auditors to make incorrect assumptions and assessments in these areas.



EXERCISE YOUR RIGHT TO REPRESENTATION



Per the
Texas Taxpayer Bill of Rights,
you have the right to engage
the person of your choice to
represent you during
the audit process.

Skillful tax audit representation is key to achieving favorable results. No one wants to be incorrectly assessed sales and/or use tax. An experienced state tax consulting firm can help reduce the risk of audit errors, find available exemptions, possible tax credits and refund opportunities, defend your right to a fair audit, protest any unfair audit assessments and represent you through the administrative hearings process if needed.

MANAGE THE AUDIT

When your audit begins (the Entrance Conference date), it can be a stressful day. Here are a few tips to help your interaction with the auditor proceed smoothly, while protecting your interests.

1 Auditor— Adversary or Friend?

Neither! Remember the auditor is not trained to assist you with the audit. They are there to find tax errors and assess any tax that they consider due. The problem is that each auditor can conduct the audit their own way. Auditors often make mistakes, and it is up to you to defend yourself.

2 Do not sign any documents without consideration of consequences

Legal documents will often be presented to you during the audit. Some of these documents will require your signature. Auditors might attempt to apply an unfair estimation technique by sending you an applicable notice. This could result in over

assessed taxes. Get help from a qualified expert before accepting or signing any document you do not understand.

3 Ask for all record requests and taxability determinations in writing

This helps both you and your auditor understand what records are required, and what is the auditors understanding of the taxability of your transactions.

4 Provide only the records and information that is requested

Do not give the auditor any records they have not specifically asked for. Auditors can sometimes request more documents than are required to conduct an audit.

5 Keep a file of copies provided to the auditor

An auditor may ask to make copies of certain sales or purchase invoices for—“further research—.” Keep a file of the copies provided to the auditor, as you will likely need to contest these invoices later.

6 Keep your files onsite

According to Texas Tax Rules, hard copy and electronic records must be made available for your auditor, but there is no requirement that you allow them to be removed from your office! As a rule of thumb, it is best to keep the records at your office to be sure they don't get lost or misplaced by the auditor. Keeping the auditor close generally results in a better outcome.

CALL IN THE EXPERTS

As a business owner, it is nearly impossible to know and understand every detail of Texas state tax laws and regulations. Therefore, just as you would hire a lawyer to represent you in court for any other legal matter, you should hire a state tax audit defense specialist to represent you during your audit with the Texas Comptroller.

At Texas Tax Group, all we do is state tax audit defense and refund requests. Our team of 15+ former Texas Comptroller State Tax Auditors,

Supervisors and Tax Policy Experts are here to help you get the best possible audit result. With offices located in Houston, Dallas, San Antonio and Austin, we have represented, over the last 10 years, more than 2,400 clients, resulting in millions of dollars in reduced audit assessments.

If you'd like to get in touch, call us at **1-855-892-8348** for a **free 20-minute consultation** today or visit texasgroup.com to learn more.



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