



OKLAHOMA
Tax Commission

**COMMON OKLAHOMA
SALES TAX AUDIT ISSUES**

IS YOUR BUSINESS AT RISK?

Introduction

The Oklahoma Tax Commission (OTC) is responsible for administering and reviewing payments and returns submitted for Oklahoma state sales tax. An assessment from a sales tax audit has the potential to add up quickly. A common misconception is that sales tax assessments are only for those taxpayers trying to avoid or evade paying sales tax. However, even businesses who are careful and have robust sales tax systems can find themselves faced with assessments due to unintentional errors. Small errors themselves may not seem material, but can become significant when spread over a period of months or years.

Moreover, many taxpayers are confused as to their CPA's role regarding their business sales tax. Despite some taxpayers thinking their CPA knows everything about their business's sales tax activity, sales tax is often explicitly excluded in the engagement letter for the annual tax return. There are several areas where an annual checkup on sales tax issues can identify potential risks with sales tax reporting. When errors are found early, corrections can be made to the sales tax system to minimize any potential sales tax audit in the future. Sales tax assessments can be generated from an OTC Field Audit, OTC Desk/Discovery Audit, or contract auditors hired by a municipality.

Some areas should be reviewed annually to avoid common errors discovered in Oklahoma sales tax audits. Below are the five most common mistakes we find during a sales tax audit:

1. Not Reporting All Sales

All sales are subject to sales tax until they are shown to be exempt (Oklahoma Administrative Code (OAC) Section 710:65-1-4 (a)). Sales tax auditors review the federal income tax returns, third-party credit card reporting found on the federal Form 1099-K, and other financial records to make comparisons between sales and sales reported to the OTC through sales tax reports. Differences are investigated, and any underreporting will be reviewed for potential assessment.

Generally, sales tax reports are based off a point-of-sale system report. Ideally, these point-of-sale reports will reconcile to the financial records. The sales tax reports often reconcile when the system is initially set up; however, as time goes by, reconciliations between the sales tax reports and the financial records get off track. This could be due to changes in circumstances or any number of other errors. Whatever the case, by making this comparison on an annual basis, differences can be researched and corrected so future years are not impacted.

2. Insufficient Documentation for Exempt Sales

Sellers are liable for the collection of sales tax on all sales unless they prove the purchase is an exempt sale, or the purchaser timely provides the vendor documentation showing the purchaser is exempt from sales tax (OAC Sec. 710:65-1-4 (a)). During a sales tax audit, the auditor reviews exempt sales to determine the validity of the exemptions claimed. If the auditor discovers that proper documentation to support the exemptions is missing, then it is flagged for assessment.

Contractors are consumers/users and must pay sales tax on all purchases of tangible personal property (OAC Sec. 710:65-7-13) with limited exceptions. If a contract sale is exempt, documentation must be kept showing the contract meets the claimed exemption. It's important for taxpayers who sell to contractors to be familiar with the necessary documentation requirements for each exempt sale as it is common during a sales tax audit to find improper documentation.

Exemption management systems should be kept up to date. Locating a missing exemption document during a sales tax audit can prove problematic, as there may no longer be a working relationship with the customer or the customer may no longer be in business.

Reviewing exempt sales documentation to determine if exemptions remain current and valid, at least annually, can identify any deficiencies. Taxpayers can then make any necessary corrections to the sales tax procedures to ensure that exemptions are properly documented going forward.

3. Failure to Pay Use Tax on Out-of-State Purchases

Purchases of tangible personal property from outside of Oklahoma are subject to use tax if used or consumed in Oklahoma (OAC Sec. 710:65-21-3). Auditors review purchases of both fixed assets and expense purchases to identify any invoices that are taxable for use tax. Fixed asset purchases are the most common purchase exceptions.

Oklahoma use tax can come as a surprise for entities based out-of-state with operations in Oklahoma. If a centralized purchasing function is located outside of Oklahoma and use tax is not considered at the time of purchase, these transactions can be assessed in a sales tax audit.

Many out-of-state companies have never reported Oklahoma use tax, and because of this, are not subject to the usual three-year statute of limitations. During an audit, auditors may review more than the past three years to assess for these out-of-state purchases. Due to this expanded look-back window, if use tax appears to be an issue, the taxpayer should consider filing Oklahoma use tax returns. A casual Oklahoma use tax account can be easily opened through the taxpayer's OkTAP account via oktap.tax.ok.gov. The business can identify and quantify these transactions by reviewing any out-of-state purchases for potential Oklahoma use tax issues on an annual basis.

4. Not Charging Sales Tax

Businesses not charging sales tax to customers should review these practices annually. Auditors look at all sales in detail to determine if there are sales of tangible personal property where sales tax is required. Perhaps the business has expanded from its origins without considering the sales tax consequences or the business has misinterpreted the tax code.

Businesses who incorrectly think they are exempt from collecting sales tax can often be surprised when a sales tax audit is initiated. If the business has not filed sales tax returns, the usual three-year statute of limitations does not apply, and the auditor can look back further than three years to assess for these sales. Reviewing your businesses sales tax practices on an annual basis can help identify any misconceptions in interpretation of the sales tax code or changes in the taxability of business transactions.

5. Not Charging Sales Tax on Sale of Business Assets

Business owners may not realize that when they sell tangible personal property, a taxable transaction occurs. They usually consider that sales tax was paid when the asset is first purchased, but do not realize that sales tax is a transactional tax. That means both the purchase and the sale of a fixed asset are taxable. Sales tax auditors review the federal Form 4797 Sales of Business Property filing(s) and determine if sales tax was accounted for on all transactions listed.

Sales of business assets when a business closes are also reported on Form 4797. Common wording in purchase and sale agreements (PSA) requires the buyer to be responsible for the sales tax related to the purchase of the assets.

While the PSA agreement may make the buyer responsible for paying the sales tax, Oklahoma law places the primary burden of collecting that sales tax on the vendor or seller of the assets (OAC Sec. 710:65-7-2). Sales tax auditors review the PSA agreements to determine the amount of tangible personal property sold and make assessments accordingly.

Detailed allocations of tangible personal property, real property, and intangibles are necessary to properly account for these bulk asset sales. If any of the items purchased are considered exempt, such as inventory or for use in manufacturing, any such permits must be obtained prior to the contract sales date. Otherwise, the transaction is considered taxable for sales tax.

Resources

The OTC website, tax.ok.gov, provides many resources to assist taxpayers in complying with Oklahoma sales tax law. The following resources and links relate specifically to sales tax:

1. [Chapter 65 of The Oklahoma Tax Administrative Code](#) is a helpful resource with the administrative rules covering Sales and Use Tax.
2. [Publication D-Oklahoma Sales Tax Vendor Responsibilities for Exempt Sales](#) details vendor responsibilities for exempt sales documentation with helpful examples.
3. **Audit Guides:** The OTC has prepared guides to assist in answering common questions surrounding an audit. Sales tax audits are performed not only by the OTC's Audit Services Division, but also by contract auditors hired by municipalities to perform sales tax audits. These guides describe the procedures the auditor uses when reviewing records, explain the forms used during an audit, and provide resources for after an assessment is made.
 - [Business Tax Desk Audit Guide](#)
 - [Business Tax Field Audit Guide](#)
 - [Individual Income Tax Audit Guide](#)

The Mission of the OTC is to promote tax compliance through serving taxpayers with transparency and fairness in administration of the tax code and unparalleled customer service. Sales tax audits help ensure one business does not have an unfair advantage over another business by not charging sales tax. The goal of every OTC tax audit is to ensure compliance with Oklahoma sales and use tax statutes. Usually, these audits result in assessments of additional tax. The OTC is interested in collecting all taxes due by a business and not a penny more.

By identifying common areas where sales tax assessments occur and reviewing these on an annual basis, taxpayers can make corrections before the errors become more difficult to fix.

In summary, most sales tax audits have more than one issue identified for assessment. By reviewing these five commonly assessed areas on an annual basis, businesses can identify errors in their own practices and help to reduce some of the risks associated with a future sales tax audit.