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4. Always deliver what was promised, when it was promised. "Not delivering what is expected erodes trust, and this is a major cause for rifts in business relationships, Dergel explains. "Trust can be built only with people who know you and like you, and this is achieved by understanding what others expect from you and ensuring timely delivery on these expectations."

Editor's Note: Samuel Dergel specializes in building strong finance teams. He started his career in audit and advisory services with Ernst & Young, and went on to financial leadership roles in the manufacturing and technology sectors. He is the author of *Guide to CFO Success: Leadership Strategies for Corporate Financial Professionals* (Wiley & Sons). ❑

TAX & REGULATORY COMPLIANCE

State Sales and Use Tax Trends

(Quick Code 041504)

By Diane L. Yetter

The Marketplace Fairness Act of 2013—which would authorize states that meet particular criteria to require remote sellers that do not meet a "small seller exception" to collect their state and local sales and use taxes—is still on hold. While it was passed by the Senate on May 6, 2013, it is still pending in the House. It is expected that supporters will reintroduce another version this year.

As states continue to grapple with whether and how to tax digital goods, which includes anything delivered or used in an electronic format, there are three main issues in consideration.

Taxability of Digital Goods

The taxability of digital goods comes down to determining what is being sold or bought. Is it defined as a good (electronically delivered software), a digital good (a Streamlined Sales Tax term that includes digital books, music, movies and similar items), or a service?

States are not consistent in how they define digital goods. For example, some states, like New York, consider SaaS (Software as a Service) to be computer software. South Carolina considers it a communication service. Iowa considers it a non-taxable service.

Of course, before you can figure out if SaaS is taxable, you first must determine the state that has the right to tax it—which we refer to as "sourcing." When something is "delivered" it is much easier to determine the sourcing—you can look at the ship-to address. But, when something is *accessed*, what address should be used? The billing address? The user location? The hosting location? Again, states vary regarding their rules.

Many professionals are debating whether services that use remote access—such as the use of a database like Dunn & Bradstreet or a credit reporting service—are classified as a service or software. The answer to this question will drive taxability and sourcing rules.

Part of the decision is based on how much control or ability to generate reports is available to the user. Michigan has been aggressively assessing sales and use tax on these types of charges but has lost three times in court.

What Is the Obligation of the Seller Based on the User Location?

Another challenge in the digital goods area is whether the seller has an obligation to tax based on the user's location. This can be an issue for software licenses as well as digital goods. If a customer licenses an application that will be used by 100 of its employees in different locations, which jurisdiction has the right to impose tax?

Historically, when tangible goods (a gold master) were delivered to a customer location, that is the jurisdiction where the seller sourced the goods. However, in many of today's business models, no tangible property is "delivered" by the seller. Rather, maybe a license key is provided and the customer simply downloads the software and unlocks 100 copies. Does the seller have an obligation to know where these users are located? That is certainly being questioned by the states.

What if the contract requires the user to notify the seller of all the users and their locations? In these situations, the seller likely does have the obligation to tax based on user location. But, if the user locations are unknown to the seller, should they just tax based on the address they have for the customer? Probably yes—but the buyer might want the seller to exempt if users are located in non-taxable states.

Controllers need to be aware of the complexity related to the taxability and sourcing of digital goods—whether they sell or buy them. Sellers need to be prepared to meet the complex tax categorization and sourcing rules as well as the ability to tax using an apportionment methodology if requested by their customers. Buyers certainly need to be aware of where they are using digital goods and accrue use tax as applicable.

Tax Base Expansion

Another way the states are working to increase the tax they collect is by amending their tax base. One way they are doing this is by imposing tax on separately stated items if they are required to complete the sale.

Ancillary items that are mandatory, such as a maintenance contract, have usually been taxable if the associated item is also taxable. But optional items that are separately stated often can qualify for an exemption. However, if they are "required to complete the sale," such as an inspection post-installation, this could be deemed taxable and part of the sales price—even if separately stated.

Controllers should review their sales agreements and terms and conditions to determine what types of charges are "mandatory" for the sale to be deemed completed.

Audit Concerns

States enforce their laws by conducting audits. We've seen states get more aggressive during audits by enforcing their provisions literally, where in the past they looked more at the intent. They are challenging nexus and looking for any activity in the state to establish presence.

In addition, they are being strict on the validity of exemption certificates. Any minor error will deem the certificate invalid. And if you don't have all your certificates, you may have limited time to obtain them if they are identified as a potential taxable sale.

Use Tax

Another area where states are focusing their attention is on use tax. If you aren't accruing use tax, you likely have exposure. There are very few businesses that don't buy something where use tax is due. Controllers should evaluate their purchases and make sure processes and procedures are in place to monitor and remit use tax.

For public companies, additional concerns relate to the impact of uncollected sales tax or unreported use tax on the financial statement. Depending on the business and the materiality of its sales and use tax obligations, there might be a disclosure required. Being aware of external auditors' philosophy and their companies' position will help controllers to manage expectations. At a minimum, internal controls should be in place to monitor and evaluate any potential exposure in the sales and use tax area to minimize any SOX deficiencies.

Controllers should ensure that they have controls and procedures in place to monitor tax law changes, implement corrective action, and document their adherence to sales tax laws. As tax law changes occur, timely compliance with the rules will minimize additional costs related to interest and penalty. For controllers who have a sales tax collection responsibility, under-collecting tax results in an average nine percent reduction in revenue. Not many companies can absorb this level of assessment.

Editor's Note: Diane L. Yetter is president of YETTER, a sales and use tax consulting firm. ❑

PAYROLL COMPLIANCE

Ensure Proper Withholding on Form W-4

(Quick Code 041503)

By Raeann Hofkin, CPP

The W-4 form helps employers collect the information needed to estimate the amount of federal income taxes to be withheld from the employees' paychecks.

Employees are ultimately responsible for ensuring that adequate federal income tax is withheld from their paychecks. If an employee's withholding results in the employee either owing too much tax, or receiving a huge refund, the IRS can charge the employee a $500 penalty for submitting a false W-4.

While it is not advisable for employers to offer withholding advice, it is highly recommended that employers refer employees to the detailed IRS Withholding Calculator and worksheets at http://www.irs.gov/Individuals/IRS-Withholding-Calculator. The calculator will help employees to figure the correct number of withholding