Indirect Tax Analyzer
Automate your reverse audits to facilitate managing sales and use tax expenditures
Managing sales and use tax expenditures can be some of the most frustrating and yet rewarding responsibilities undertaken by the accounting departments of companies.

Frustrating, because the number of transactions involved - which have to be scrutinized during a reverse tax audit - is huge and requires many hours. But rewarding because – if done properly – the potential opportunity for mitigating tax liabilities and receiving a tax refund is significant.

**Sales tax vs. Use tax: What’s the difference?**

Sales and use taxes are imposed in 45 states and the District of Columbia, and they are mutually exclusive: either sales tax or use tax is imposed on a transaction. Never both.

**Sales tax** applies to all retail sales of tangible personal property, unless such property is explicitly exempt from taxation. Services are generally not subject to sales tax, unless they are specifically enumerated by statute.

**Use tax** is imposed on consumers of tangible personal property that is used, consumed, or stored in the state. Use tax generally applies to purchases from out-of-state vendors who are not required to collect sales tax on their sales.
Who’s keeping track? And how?

Companies often use their accounts payable departments to review sales/use tax remitted to suppliers and analyze self-assessment of use tax accrued on purchases to identify errors. These companies may then launch a review of purchase transactions by the accounts payable department and perform a reverse audit to ensure that the correct sales or use tax has been charged or accrued.
This is how the process works.

1. **Review by accounts payable department**
   Companies would need to review large volumes of transactions to identify overpayments due to sales and use tax exemptions or exclusions that may not have been correctly taken into account by suppliers. This includes the following:
   - Has accurate sales/use tax been charged?
   - Has use tax been properly accrued?
   - Have appropriate sales tax exemptions and adjustments been reflected in light of evolving state and local tax laws?

2. **Reverse sales and use tax audits**
   Companies may, as an additional review procedure, conduct reverse audits internally or through third party consultants. Reverse audits can identify overpayments of sales/use tax and over-accruals of use tax, which may mean the company is due a refund. In general, reverse sales tax audits involve the review of the following:
   - Sales and use tax system, procedures and tax returns;
   - applicable accounts payable procedures and relevant data;
   - use tax work papers;
   - key contracts and leases;
   - potential missed exemptions;
   - classifications of services and products for potential differences;
   - supporting documentation and work papers related to potential refunds; and
   - summary of refunds by jurisdiction submitted to the state or to the original supplier.
3. Sales and Use Tax Exposure Analysis

Companies may, as an additional review procedure, conduct an exposure analysis internally or through third party consultants. An analysis of exposure can identify underpayments of sales/use tax and under-accruals of use tax, which may mean the company owes more money than they have remitted. In general, exposure analysis involves the review of the following:

- Sales and use tax system, procedures and tax returns;
- applicable accounts payable procedures and relevant data;
- use tax work papers;
- key contracts and leases; and
- classifications of services and products for potential differences.

4. Sales and Use Tax Diagnostic Service

In some instances, companies may want to gain a general sense of how well their current sales/use tax process is functioning. Diagnostic services combine the process of reverse audit and exposure analysis, by searching for instances where sales/use tax law was incorrectly applied. These services will identify both overpayments/over accruals and underpayments/under accruals. In general, a diagnostic service involves the review of the following:

- Sales and use tax system, procedures and tax returns;
- applicable accounts payable procedures and relevant data;
- use tax work papers;
- key contracts and leases;
- potential missed exemptions;
- classifications of services and products for potential differences; and
- supporting documentation and work papers related to potential refunds.
The problem with both of these procedures is that they are extremely labor-intensive and time consuming, requiring hundreds of hours of data compilation, review and coordination by internal staff who could be better deployed on other projects. What’s more, despite the time, effort and labor, this traditional way of managing sales and use taxes may not, in fact, identify all the potential exemptions and adjustments available.

Advancements in tax technology can today streamline labor-intensive processes such as reverse audits, resulting in increased efficiency and significant refund opportunities.

PwC indirect tax specialists have developed an automated reverse sales tax tool, Indirect Tax Analyzer, which uses proprietary software tools to review vendor invoices and identify overpayments as well as missed sales and use tax exemptions in a timely, efficient and effective manner. The Indirect Tax Analyzer also can be employed for additional tasks, such as system diagnostics, audit preparations, managed audits, reserve calculations, and even as a tool for significant Mergers and Acquisition activity.
The example below provides an illustration of potential refunds obtained by using the Indirect Tax Analyzer. The example is based on the following assumptions:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Sales Tax Rate (blended)</td>
<td>8%</td>
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<tr>
<td>Purchases</td>
<td>$500 million per annum</td>
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<tr>
<td>Sales and Use Tax Liability</td>
<td>$40 million per annum</td>
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<tr>
<td>Misidentified Exemptions</td>
<td>$1.5 million per annum</td>
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Gather and Upload Data: Accounts payable and other key data related to the $500 million in purchases is obtained and loaded electronically from the company Enterprise Resource Planning (ERP) software into the Indirect Tax Analyzer.

Scan and Extract Data: $40 million of sales and use tax and other data from invoices is scanned and automatically analyzed with Indirect Tax Analyzer.

Enrich, Reorganize and Automate Data Analysis: The data is enriched and reorganized. PwC’s Tax engine within Indirect Tax Analyzer automates a review of taxability decisions based on accounts payable data, scanned invoices and other information.

Output Payments Summary by Jurisdiction: Summary by jurisdiction of sales and use tax over-payments and under-payments are provided as an output. The Indirect Tax Analyzer summarizes $1.5 million of misidentified exemptions per annum ($4.5 million over 3 years). Refunds are filed with each identified jurisdiction.
The Indirect Tax Analyzer eliminates many of the common barriers that occur using traditional, labor-intensive procedures in managing sales and use taxes and performing reverse audits. The table below details some common barriers and the potential solutions provided by the Indirect Tax Analyzer.

<table>
<thead>
<tr>
<th>Common Barriers</th>
<th>PwC Automated Solution</th>
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<tr>
<td>The compilation and review of data to identify over-payments and under-payments is a time and resource consuming process.</td>
<td>Indirect Tax Analyzer analyzes a full data set. It minimizes the need for manual reviews of invoices, purchase orders, and other data.</td>
</tr>
<tr>
<td>There may be uncertainty regarding sales tax exposures that require a cost-benefit analysis to determine whether a reverse audit is cost efficient.</td>
<td>Indirect Tax Analyzer identifies refunds and exposures to perform a cost benefit analysis before filing a claim in each jurisdiction.</td>
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<td>Third-party service providers may use internal resources to obtain data and other related information.</td>
<td>Our technology and approach enable more independent work by PwC, allowing your company the ability to better allocate your internal resources.</td>
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Historically, companies have managed sales and use tax expenditures with accounts payable departments, performing reverse sales and use tax audit procedures manually.

The Indirect Tax Analyzer can assist companies in managing sales and use tax expenditures effectively and efficiently, potentially resulting in significant refund opportunities.
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