


# Lessons Learned From a Recent Audit

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I was recently engaged to perform audit representation services on behalf of a taxpayer who owns and operates an automobile repair shop. After the Nevada Department of Taxation issued a deficiency notice, I was contacted to review the audit work papers and determine whether a Petition for Audit Redetermination should be filed. Needless to say, with an assessment including interest and penalties that was quite substantial, the taxpayer was clearly upset and obviously stressed. When I reviewed the audit work papers, two items became conspicuously clear; third party services billed by the taxpayer to his customers were consistently assessed, and the audit extrapolation was based on sales reported on the taxpayer's federal income tax return instead of sales generated from the sample months.

For reasons outside the scope of this article, had certain accounting tasks been performed, the audit would have closed quickly with minimal assessment. Similar issues may affect your clients who have an obligation to collect Sales Tax - reconciling sales reported on federal income tax returns to sales reported on Nevada sales tax returns; and Nevada sales tax laws and regulations to determine proper billing for subcontracted work.

First and foremost, whether your client's year-end bookkeeping is performed by your practice or your client has an internal accounting staff, time needs to be reserved to reconcile revenues reported on the federal return to those reported on the Nevada sales tax return if your client has an obligation to collect sales tax. Reconciliation should occur shortly after the federal tax return is filed, with any differences explained and documented. This mirrors a standard audit procedure performed by Nevada sales tax auditors. Time spent prior to an audit to resolve and explain differences will expedite an audit and give the auditor a level of comfort that sales are not being under reported to Nevada.

For this particular audit, revenues on the federal return were substantially higher than those reported as gross sales to Nevada on the sales tax return. Attempts to reconcile the revenues were unsuccessful as not all records were available. Additionally, sales invoices were not sequentially numbered, leading the auditor to believe that

sales were not reported on the sales tax returns for the audit period. The auditor was required to extrapolate audit exceptions based on sales from the federal tax return, instead of the sales from the sample months, which is the usual and customary method.

The other major issue encountered during this audit was invoicing by the taxpayer. Specifically, certain specialty auto repair services were subcontracted throughout the audit period. These services were paid for directly by the taxpayer, and sales tax applicable was paid by him. Upon completion of these services, the subcontracted services were billed on the taxpayer invoices to his customers as "sublet services", with no breakout for parts, services, and tax. The billing also included a mark up. Accordingly, these invoices were found to be taxable since auto repair and maintenance services must itemize parts, labor, and tax pursuant to NAC 372.390 and NAC 372.400(1).

The lesson to be learned from this audit is that time used to review records may actually lead to savings; especially when you factor the time needed to satisfy an auditor that the proper tax has been captured and remitted, not to mention any assessment costs. Another consideration - should your client need sales & use tax representation, professional representation fees can often be held to a minimum when business records meet the standards required by the Nevada Department of Taxation.



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