Caught unaware?

As with most taxes, the Ohio use tax puts a burden on the taxpayer. **Interviewed by Jerry Roche**

Does your company ever buy materials, equipment or services and not pay sales tax at the time of purchase? Many Ohio companies are unaware of their obligation to obtain a use-tax account number and file use-tax returns on a regular basis. If your company does not regularly review its purchases for potential risk to use tax, it could face mounting financial liabilities and penalties.

"Reviewing a company's use-tax exposure is most often a specialized service offered only by boutique consulting firms, but it's part of the overall relationship with our clients," says Michael J. Stefanek, a partner with Skoda, Minotti & Co. "We work hard to keep clients apprised of things like this that can negatively affect their business. You never know when the hammer's going to drop."

Smart Business discussed Ohio's use tax with Stefanek.

What does Ohio's use tax cover?

The use tax is basically a parallel to sales tax in Ohio, imposed on purchasers of tangible personal property or taxable services that are consumed, used or stored here in the State of Ohio. All companies are subject to a use-tax reporting requirement when a vendor does not charge Ohio sales tax.

With every general rule, of course, there are exclusions and exemptions. For instance, there is a manufacturing exemption for manufacturers buying materials to be used in a manufacturing process, which is elaborately defined statutorily and in case law.

But if a company buys 20 computers online for its office here in Ohio and the online vendor doesn't charge Ohio sales tax, that company would owe Ohio use tax for those items. It must register with the state, obtain a use-tax account number, and file use-tax returns on an annual, quarterly or monthly basis.

The burden is on the taxpayer to report the tax. But, unlike individuals, businesses are a more likely candidate for an audit because bigger dollars are involved.

Michael J. Stefanek
Partner
Skoda, Minotti & Co.

What are the risks of not filing use-tax returns?

The longer it takes for a company to finally recognize that it hasn't been paying the tax, the greater the risk becomes. If a company never filed a use-tax return, the State of Ohio can technically audit back to its first day of business. However, if a company has been filing returns, then there's a four-year statute of limitation from the date of filing. For companies that haven't been aware — or haven't filed use tax returns — it would be advisable to first assess what their exposure might be.

There are ways to further minimize any obligation. If a company determines that it owes money and never registered, it has the ability to approach the state — through an adviser — on an anonymous basis and 'come clean.'

This voluntary disclosure process is similar to tax amnesty. In this process, the state generally will agree to limit the audit look-back period to 39 months with no penalties.

Are certain companies more at risk for use-tax audits?

The use tax is applicable to every business, but the State of Ohio is aggressively pursuing construction businesses that don't have an account. It seems more applicable to subcontractors and trade organizations than general contractors, because they're making a lot more material and equipment purchases.

The main area of the state's focus is the alleged abuse of tax-exemption certificates. Take an HVAC contractor that buys bulk sheet metal to fabricate into ductwork for installation on its construction jobs. The company will typically work for both taxable and tax-exempt customers. It's not obligated to pay sales tax on the sheet metal if it is ultimately incorporated into nontaxable jobs, but some companies may use the same materials and tools on taxable jobs as well.

Keep in mind that the little things add up. For instance, if a company purchases several small tools or supplies under a tax-exemption certificate, the burden is on the taxpayer to prove to the State of Ohio that the tools were used *only* on tax-exempt jobs. This is a difficult burden to bear for most companies.

You'd like to think that most agents are reasonable, but techicallly if you don't have the documentation to substantiate the exemption, they can impose and assess the tax.

What's the bottom line?

The bottom line is to manage your risk. If you haven't reviewed your potential use tax exposure, it makes good business sense to take the time to understand the tax implications of your company's purchases and assess the damage. From this process, business decisions can be made.

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