

Publications

State and Local Tax Alert: Ohio Department of Taxation to Begin Use Tax Audits

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CLIENT ALERT | 6.15.2015

In May, the Ohio Department of Taxation mailed letters to Ohio direct pay permit holders indicating the Department's intent to conduct audits for Ohio sales and use tax compliance on purchases. The Department's letters are friendly reminders that vigilant compliance remains ever important. That's the easy message. At Vorys, we dug a little deeper and have determined other, more meaningful, points to consider.

The audit intent letters were sent in two waves. The first wave was dated May 4, 2015. Those letters were directed to Tier 1 audit candidates. The Department is intent on auditing Tier 1 candidates more than others. The reasons for this include one or more of the following characteristics:

1. the business reports minimal amounts of Ohio use tax on direct pay permit returns;
2. the business uses manual procedures for use tax compliance (*i.e.*, no percentages apply to AP totals); and
3. the business has not been audited since before 2005.

The second wave of letters was dated May 8, 2015. These letters were directed to Tier 2 and Tier 3 audit candidates. Tier 2 candidates are those direct pay permit holders that were audited between 2005 and 2012 and/or that employ a percentage-based compliance method (*i.e.*, either a single rate or percentage by account). Tier 3 candidates use percentages and have been audited more recently than 2012. As the tier system suggests, the Department is most keen on auditing Tier 1 candidates first, Tier 2 candidates second, and so on.

In addition to the normal risks and hazards associated with the audit, the Department hopes to use this program to reduce the overall number of direct pay permit holders in Ohio. The Department currently "disfavors" the direct pay permit program and likely will seek ways to move or transition businesses to a consumer's use tax account. Businesses should consider seriously this objective and what it could

mean for in terms of issuing certificates of exemption to suppliers and vendors. In addition, the Department may require businesses to develop percentage-based compliance programs as a condition of keeping direct pay permit status.

Although we have uncovered significantly more information about the program and the Department's intent than what was conveyed in the audit notice letters, we cannot predict when the audits will commence, or the myriad of other procedural options at the Department's disposal for audit purposes. However, businesses should receive another letter indicating that an audit officially has commenced when/if the Department decides to move forward.

So, what does this mean for you? If you received a letter, we believe your business still has time to prepare for the audit. Indeed, the best time to minimize the adverse results of an audit is prior to the time it commences. The best protocol is to: (1) review compliance procedures; (2) review accounting and operational changes that occurred since the prior audit; (3) consider the effects of mergers, acquisitions and business expansions; (4) review changes in statutes or case authorities since the prior audit; (5) consider a test check to find weaknesses/strengths so that your business can negotiate audit procedures and defend itself in the most informed manner; and (6) discuss all these points with an experienced professional knowledgeable in the law and in audit defense.

The SALT team at Vorys has over a century of experience in defending these types of audits. We can take the lead on these audits for you or we can serve as behind-the-scenes advisors. We would be pleased to answer any questions you might have.