

Tax Compliance Doesn't Have to Be So Taxing ... *Outsourcing Can Give You the Edge*

Minimizing property tax and sales tax administrative costs can create a significant competitive advantage over your competition. Creating this advantage requires that you look objectively at your operations, assess the situation and implement some basic controls.

BY MATT MCFARLAND

Tax administration costs are an unavoidable cost of doing business. However, if you take a close look at your in-house operation or your outsourcing provider and ask yourself, "Is there a better mousetrap? How can we improve efficiencies?" Recognizing the significance of the costs associated with marginal or poor performance in the tax administration area is the first step to creating competitive advantage. Every dollar cut from your overhead equals some multiple of revenue. Improving the efficiency and effectiveness of the tax compliance function creates the equivalent of top line growth while improving operational efficiencies.

Every year, leasing companies needlessly pay hundreds of thousands of "extra" dollars simply because of lack of attention and lack of expertise. Depending on the expertise and experience of your vendor or your tax staff, as well as the processes and systems employed, compliance costs vary significantly from company to company. Improving staff training and streamlining processes creates immediate and lasting margin improvements and competitive advantage over the competition. Performing periodic but random audits of your vendor will identify flaws in your vendor's processes.

The cost of tax compliance is significant. Considering the ever-increasing cost of tax preparation software, hardware, human resource costs, benefits, training, penalties and interest, and outsourcing, the cost of the simple compliance function takes on a new patina. Ultimately, your up-front due diligence in hiring an outsourcer or creating and managing the in-house function will pay dividends in tax savings for years to come.

Sales Taxes

The sales tax (i.e. use tax, rental tax, lease tax, etc.) function requires knowledge in a staggering number of different regulations, forms, tax rates, and due dates. The sheer volume of the different regulations can create confusion that causes errors in the collection and payment of these taxes. The potential financial and reputation/goodwill exposure of a leasing company is significant.

While all of these taxes generally create revenue for a jurisdiction, leasing professionals must take care to apply the proper tax rate or risk penalties and interest, customer relationship failures, and worse a potential class action

suit. Knowing the proper tax rate to apply to each specific transaction is critical to proper compliance and avoiding penalties and interest.

A lessor must know the type of tax to apply for each individual lease based on a very specific set of circumstances. For example, a lessor located in New Jersey leasing equipment (a true tax lease) to a Missouri lessee would collect a use tax of 4 percent of the monthly rental payment amount for the duration of the lease. If the lessor were located in the same state, in this case, Missouri, they would be required to collect a sales tax of 8.25 percent, a difference of 4.25 percent.

Taxing jurisdictions treat conditional sale/financing leases differently. Some require that the sales tax be paid up front at the inception of the lease. Others require that the tax be collected over the lease term. Additionally, some cities and counties can require a tax in addition to the state that is collected differently than the state tax. For example a state may require the sales tax to be paid upfront while a city requires a lease tax to be collected over the lease term. These variances in taxation create a confusing labyrinth of tax collections and payments making compliance difficult.

In addition to sales and use taxes are the leasing specific taxes often called lease taxes or rental taxes. These taxes are specifically levied on leased equipment in lieu of sales or use tax. These rates too can be different and need to be researched. Alternatively some home rule jurisdictions will impose a specific tax targeted to leased equipment only. Unfortunately the tax rating services utilized by most leasing companies only provide sales and use tax rates and ignore the leasing taxes specific to our industry. Leasing companies are left on their own to navigate the complexities of the various tax regulations.

Another way to maintain vigilance in the sales tax area is to contact jurisdictions and anonymously inquire about leasing specific tax rates and rules. Remember, our industry is unique and tax rules can be interpreted in a variety of ways. Sales tax regulations create a minefield of potential problems that can cost you significant money.

There is significant opportunity for improved compliance and cost minimization in the sales tax arena. With the numerous jurisdictions and the variety of tax rates and rules, it is impossible to maintain "compli-

ance” without a full-time dedicated sales tax staff. Without a full-time staff dedicated solely to the sales tax function you may want to consider outsourcing the compliance function or consider purchasing sales tax consultation services in blocks of time suitable to your particular situation. Maintaining true compliance in the sales tax arena will save thousands of dollars at audit time.

Property Taxes

Property taxes related to a portfolio of leased assets present challenges not faced by other industries. For example, consolidated tax bills for multiple lessees, appropriate tax allocation for lessee reimbursement, assets being moved without notice from one taxing jurisdiction to another, assets rolling off lease in the middle of a tax year, buyout quotes — the list goes on. Combine these issues with the significant peaks and valleys of staffing required to properly maintain compliance in the property tax function, and you get an idea of why property taxes get out of control so quickly.

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Lessors are saddled with mountains of paperwork and varying compliance requirements from thousands of taxing jurisdictions. All of these jurisdictions have different forms, deadlines and methodologies for determining taxes making the compliance function a difficult task. Because of these complexities, many companies perform the function marginally. “Marginal performance” is defined as missed filing deadlines and missed payment deadlines, paying erroneous taxes due to rollover assessments and duplicate assessments, and not challenging erroneous assessments to reduce tax liabilities to correct amounts. Marginal performance will cost you thousands if not hundreds of thousands in excess taxes, penalties, and interest.

Why is the property tax function so susceptible to marginal performance and the related costs? Consider the timing of the taxing jurisdictions deadlines. A large portion of the current years filings and a large portion of the previous years tax payments all come due in the first four months of a calendar year while the remaining eight months of the year can be relatively uneventful. It is difficult to justify maintaining a full-time staff of qualified tax professionals all year when the bulk of the work is performed in only one calendar quarter. Consequently the available staff is inundated with mounds of tax bills and renditions that create the perfect opportunity for errors — errors that will cost you money.

Simply having enough hands available is not the answer to this dilemma. Property tax administration requires specialized knowledge of each taxing jurisdiction where your lessees are located. Simply feeding bodies to the function to “make the deadlines” will create more problems through erroneous filings, late payments and inaccurate asset classifications. Assessors look for consistency between tax years. Any changes in filing methodologies create an administrative bottleneck during the very time that the tax staff is already under extreme pressure and buried in forms and paperwork.

With all of the potential problems identified, here are some ways to eliminate them and create competitive advantage.

Proper Asset Classification

Look beyond the general ledger and fixed asset classification to the true asset description. Thousands of excess dollars are paid into

jurisdictions every year because the tax code is too complex and untrained staff are unaware of proper depreciation methods and exemptions that exist to create the appropriate tax liability to the lessee. If you can show to your lessee that you are minimizing his costs you add value to your contracts and become more competitive.

Proper Asset Reporting

Control the reporting of assets for property tax purposes. Most leasing companies leave the reporting of finance type/conditional sales leases to the lessee. But all lessees do not report the assets much less pay the taxes. The lessor will likely be responsible for the taxes and penalties and interest due to the fact that they hold title to the equipment or maintain a security interest in the equipment. Assuming the lessee does not pay the taxes and the asset has to be recovered, a tax lien will impair the marketability of the asset.

The rationale for controlling all property tax reporting is simple. Aggregate the entire portfolio under common administration so you know the taxes are properly paid, and you markedly improve your chances of maintaining the marketability of the portfolio. If a portfolio sale should occur, the ability to prove portfolio compliance and any outstanding tax liabilities will reduce any “holdback” the purchaser may require.

Double Assessments

Double assessments occur for a variety of reasons. Sometimes a portfolio sale creates double assessments because the taxing jurisdictions are not properly notified that the buyer is now reporting the assets previously reported by the seller. Unless the jurisdiction is notified, double assessments will occur. Not notifying the assessor of ownership changes will require your staff to identify and research erroneous tax bills during the busiest time of the tax season. If your tax staff is not paying close attention, these tax bills will get paid and the tax cannot be recovered from the lessee.

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Assets Relocated by Lessees

Lessees move equipment from one location to another almost daily, it seems. When an asset is relocated, the assessors should be notified to avoid double assessments and rollover assessments. Assessors will continue to send tax bills for assets reported in previous years if they are not notified that the asset is moved, retired, etc.

Asset Cost Incorrectly Reported

Taxing jurisdictions have various definitions of the “cost” or “basis” for which you are to pay property taxes. Knowing the nuances of the individual jurisdictions, and paying taxes on the proper amount can reduce the tax expense to your lessee, but it can also prevent a lessor from incurring penalties for under-reporting. This creates still another opportunity for mistakes and overpayments in taxes.

Other Considerations

Times, they are-a-changin! Sarbanes Oxley, SAS 70 and a renewed focus on the companies executives’ role in financial reporting is creating a new environment. Many accounting firms look at the tax function closely regardless of the “materiality” to the overall financial statements. This

means your procedures must be documented and functioning to minimize any potential negative impacts of the tax compliance functions.

It is important that your outsourcer maintain a Type II, SAS 70 compliance certificate if you are publicly traded or planning to go public. Even non-public companies need to consider these regulations in the event of a sale or merger with publicly traded organizations.

Summary

Taxes are an ongoing requirement and the best way to address the compliance function is to assess your particular situation and make any changes necessary to insure you minimize costs and maximize effectiveness. Here is a quick list of the most salient points covered above. Hopefully they can save you money this year.

- Objectively review the tax compliance functions.
- Assess processes and associated financial and reputational risks.
- Implement processes and controls to insure risk minimization.
- Recognize the cost of “marginal performance.”
- Every dollar saved in tax administration equals some multiple of top line revenue.
- The cost of tax compliance is significant due to human resources, training, software, overhead costs and marginal performance.
- Taxes are not generic and do change by jurisdiction.
- Cities and counties often have different requirements than the state.
- Tax rating companies do not provide the necessary “leasing” tax rates for the leasing industry.

- Tax staffs should be dedicated to the tax function full-time to be most effective and minimize marginal performance issues.
- Allocating untrained staff to the tax functions during “crunch time” creates additional problems.
- Contact taxing jurisdictions where assets are located to insure accurate collections and payments.
- Properly train the tax staff and make them “tax wise.”
- File property taxes for conditional sale contracts.
- Maintain a strict processing environment to ensure taxes are minimized.
- Identify problems early to prevent problems from arising during the “crunch times” of the tax season.
- Consider purchasing a block of consulting time to assist your staff through the busy tax season. *m*

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