state tax notes®

# Deep in the Heart of Taxes: Federal Budget Affects States

**by Robert Peters and Dustin Jensen**

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In this article, the authors address the state tax implications resulting from President Trump's proposed federal budget, which includes substantial reductions in the funding of numerous health, education, and welfare programs. The proposed reduced federal spending in those areas is likely to increase pressure on the various states to close state budget gaps through stepped up tax enforcement efforts and continued expansion of the state sales tax base of goods and services subject to tax. With that in mind, the authors provide recommendations on how businesses can prepare themselves to limit potential liability resulting from heightened audit practices and expansion of activities that previously thought to be exempt, they may now find are considered within the web of taxable goods and services.

Donald J. Trump has wasted no time attempting to push his agenda through Congress. Despite setbacks such as the failed attempt to repeal the Affordable Care Act, he has maintained his priority for a 2018 budget that includes $54 billion in increased military and homeland security spending. These spending increases would be offset by monumental reductions in virtually all other forms of discretionary spending.[1] And over the next 10 years, the Trump administration hopes to further reduce aggregate federal spending by an estimated $10.5 trillion.

Previously, huge budget increases were offset by larger tax increases, which are not on the table with the current administration. In fact, the proposed tax plan is revenue-neutral and would offset proposed tax cuts by reducing deductions, closing loopholes, and repatriating corporate cash held overseas.[2]

According to the trickle-down economic theory promoted during the Reagan years, federal government actions taken on a macro level to encourage business development ultimately trickle down to benefit the individual taxpayer. The same philosophy was espoused for state and local governments. One economic reality is that as the federal government cuts budgets — particularly for social welfare, medical, health, or education programs — many of those costs are borne directly by states. Second, federal block

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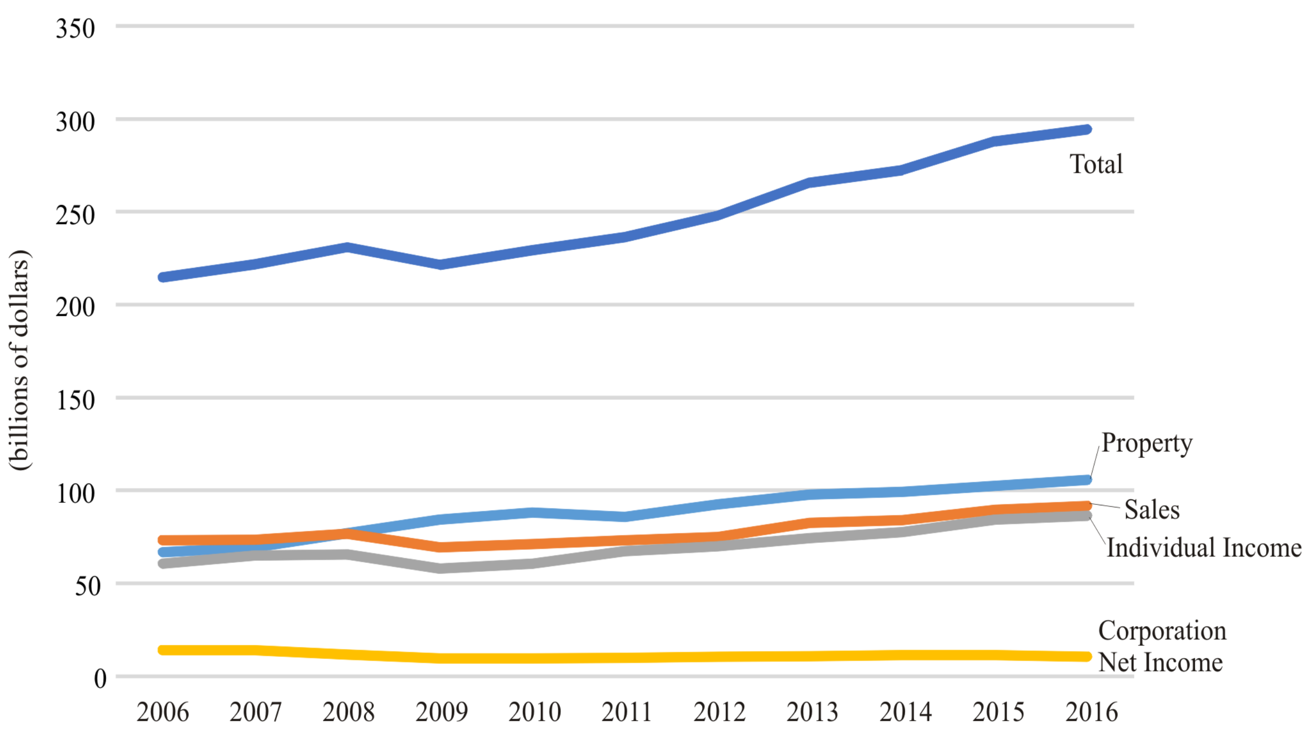
[1] *See* Alicai Parlapiano and Gegor Aisch, "Who Wins and Loses in Trump's Proposed Budget," *The New York Times*, Mar. 16, 2017. Examples of the proposed discretionary budget changes result in reductions of more than 31 percent to the EPA, 29 percent reduction in state and other developmental programs, 16 percent reduction in health and human services, and 14 percent in education. Office of Management and Budget: President Trump's America First, "A Budget Blueprint to Make America Great Again," Mar. 16, 2017. *See also*, Trump Team Prepares Dramatic Cuts.

[2] Trump proposed tax plan, *see* James R. Nunns, Leonard E. Burman, Jeffrey Rohaly, Joseph Rosenberg, "An Analysis of Donald Trump's Revised Tax Plan," Tax Policy Center, Urban Institute & Brookings Institute, Oct. 18, 2016.

**Figure 1.**
**Historical State and Local Tax Revenue Trends for Selected Taxes (Q3): 2006-2016**




*Source:* U.S. Census Bureau, Quarterly Summary of State and Local Government Tax Revenue.

grants to states are likely to dramatically decline once federal programs are slashed by as much as an estimated 25 percent.[3] The Congressional Budget Office tracking report (below) confirms that a substantial portion of the federal budget allocated as grants to state and local governments has been increasing as a percentage of GDP. With the new administration, that trend is about to turn dramatically in the opposite direction.

Unlike the federal government, which can literally print money to fund increasing deficits, every state except Vermont has a balanced budget requirement. So when a recession hits or the federal government allocates less money to states, major shortfalls in state and local budgets are likely. Consequently, legislatures will be forced to find other revenue sources to close large budget gaps.

[3] *See* E. Park, "Medicaid Block Grant Would Slash Federal Funding, Shift Costs to States and Leave Millions More Uninsured," Center of Budget and Policy Priorities, Nov. 16, 2016.

If history is an indicator of the future, one need only look at how the states reacted after the most recent financial meltdown in 2008 to 2009 to gauge what would happen should federal funding of state programs significantly decline during the Trump administration.

### State Budget Outlook

A perfect storm appears to be forming on states' economic horizon, caused by:

- the threat of massive reductions in federal subsidies to state health, education, and welfare programs such as Medicaid and public assistance; and
- real reductions in tax collections because of changing economic trends.

According to the National Association of State Budget Officers, state revenues have not fared nearly as well as those in the private sector despite the overall economic recovery over the past several years. Specifically, half of the states are experiencing revenue shortfalls and more than 30 spent less than pre-recession spending.[4] State budgets have been under pressure for many reasons, including reduced personal and corporate income tax collections — not to mention the impact of declining oil and gas prices and coal production. But, among the main factor contributing to declining state revenues, is the effect a changing economy has had on state and local sales and use tax collections.

Brick-and-mortar retail stores and shopping centers are dying.[5] Customers aren't flocking to shopping malls as in the past, as major retailers — such as Macy's, Sears, Target, Kohl's, and J.C. Penney — not only experienced considerably fewer in-store sales during the past holiday season, but are projecting major store closures during the coming months.[6] Many experts are questioning whether Sears and Macy's, once considered premier retailers, will make it through the year without going out of business.[7] As retail sales decline, so do state and local sales and use tax collections.

This article focuses on several state initiatives to close budget gaps that are expected to gain momentum over the remainder of the year. We will also make recommendations on how businesses operating in multiple jurisdictions can minimize the risk of unanticipated tax liabilities and administrative burdens imposed by states' assertive actions and ever-changing collection requirements.

[4]*See* "Fall 2016 Fiscal Survey of States," Dec. 13, 2016

[5]*See* Danielle Kurtzleben, "The Dying Discount Department Store," *U.S. News & World Report*, July 23, 2012; Hayley Peterson, "Department Stores Are Facing 'The Worst Results Since the Recession' — and That Highlights a Huge Problem," AOL Finance, Jan. 22, 2017; and Brad Tuttle, "5 Ways Department Stores Are Fighting for Your Business," *Money*, Feb. 27, 2015.

[6]*See* Gina Ragusa, "Here's Where Sears, Kmart, JCPenney and Other Chain Stores are Closing Across America," *Mic*, Mar. 23, 2017; and Debbie Lord, "Macy's, Kmart, JCPenney: More retailers closing brick-and-mortar stores," *The Atlanta Journal-Constitution*, Mar. 24, 2017.

[7]*See* Barbara Farfan, "Macy's Announces Store Closings for 2017," *The Balance*, Apr. 3, 2017; Wolf Richter, "Is the 2nd Half of 2017 When Sears Finally Kicks the Bucket?," *Wolf Street*, Dec. 29, 2016.

## Existing State Trends

Comprising more than one-third of tax collections in many states, sales and use taxes are a primary source of revenue. In Florida and Texas, which have no individual income tax, that percentage is closer to 50 percent.

When federal funding of state programs declines or a weaker economy reduces income tax collections, sales and use taxes often increase to address budget gaps. This approach has taken shape in various ways, including:

- raising tax rates, a politically unpopular approach typically used as a last resort, particularly in an election year;
- expanding the tax base to more goods and services, another politically unpopular action requiring legislative approval; and
- increasing audit activity by aggressively expanding the definition of what constitutes a good or service subject to tax.

While all three have been used to increase revenue, the most politically expedient option is broadening the tax base via state auditors' liberal interpretations of what constitutes a taxable transaction under existing statutes. These increased audit activities are often supported with administrative pronouncements or published rulings that may not carry the same weight as legislation, but effectively close state budget shortfalls over the short term — or at least until taxpayers challenge the audit position in court.

## State Efforts to Force Retailers to Collect Tax

Over the past 25 years, states' authority to require retailers to collect tax on out-of-state sales has been severely limited under *Quill Corp. v. North Dakota*.[8] In *Quill*, the U.S. Supreme Court ruled that retailers cannot be required to collect sales tax without a physical presence in the state. Unless Congress passes a law modifying the constitutional provisions protecting interstate commerce, *Quill* will remain the law of the land. When *Quill* was decided in 1992, less than 2 percent of all information flowed via the internet — a figure that increased to more than 97 percent

[8]Legal Information Institute, 91-0192 504 U.S. 298 (1992).

of information by 2007.[9] Likewise, e-commerce sales in 2016 alone accounted for $394 billion, or over 12 percent of U.S. sales for the year, which equates to 41 percent of all growth over the prior period. The internet is unquestionably the major vehicle for businesses and consumers to exchange information, provide entertainment, conduct commerce, and engage in social networking, which did not exist before 2000 or when *Quill* was decided.[10]

A 2015 congressional effort to overturn *Quill* via federal legislation passed the U.S. Senate, but stalled in the U.S. House. Failed federal efforts notwithstanding, states have pushed measures to "kill *Quill*" with considerable success — often inflicting significant administrative burdens on retailers. Amazon has now agreed to collect sales tax in all jurisdictions imposing sales and use taxes.[11]

## Expansion of 'Physical Presence'

States have attempted to get around the *Quill* physical presence standard by laws, regulations, or administrative determinations under various theories.

### Economic Nexus

Under this argument, states have challenged *Quill* physical presence nexus by establishing an economic presence standard, which requires a company with economic presence in the state to collect sales taxes. Alabama, for example, provides a voluntary collection program for retailers to collect a flat 8 percent sales tax and allows vendors to keep 2 percent as compensation for collection and remitting the tax. Newegg challenged the regulation, arguing that it did not meet the physical presence or nexus standard because it has no physical presence in Alabama and that the state's economic presence regulations violates the commerce clause. The state's answer to the appeal stated that *Quill* "is no longer workable in today's national economy and has significant shortcomings in practice."[12]

Other states asserting economic nexus include South Dakota, Tennessee, Mississippi, and Ohio.[13]

### Increased Reporting

Rather than directly challenging *Quill*, other states have taken the novel approach of requiring remote retailers to effectively snitch on their customers by reporting their names and addresses to the state or face significant penalties for failure to comply. Colorado is cited as the most egregious example of a state imposing recordkeeping and reporting requirements on remote sellers. The Direct Marketing Association (DMA, now the Data & Marketing Association) challenged the Colorado law and took the case to the Supreme Court, which late last year denied certiorari upholding Colorado's requirements.[14] Other states imposing similar reporting requirements on remote sellers include Kentucky, Louisiana (effective July 1, 2017), New York, Oklahoma (effective November 1, 2017), and Vermont (effective July 1, 2017).[15]

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[9] Martin Hilbert and Priscila López, "The World's Technological Capacity to Store, Communicate, and Compute Information," *Science*, 332(6025), 60–65 (2011).

[10] Facebook, the premium social networking platform, was not even launched by founder Mark Zuckerberg out of his Harvard dorm room until 2004 and did not go public until May 2012.

[11] *See* Jennifer Dunn, "Amazon.com Now Collects Sales Tax in Every State (and What That Means for FBA Sellers)," TaxJar, Mar 27, 2017.

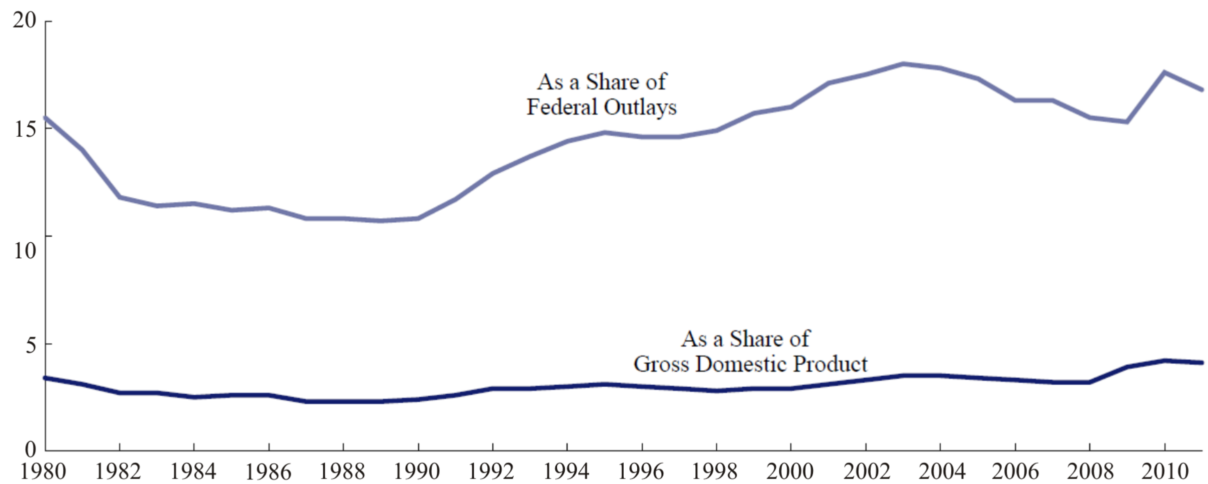
[12] Ala. Admin. Code 810-6-2.90.03. Under this regulation, out-of-state sellers without an Alabama physical presence are deemed to "have a substantial economic presence in Alabama for sales and use tax purposes and are required to register for a license with the Department and to collect and remit tax" when the seller's retail sales of tangible personal property to Alabama customers exceed $250,000 per year based on the previous year's tangible personal property in Alabama by means of catalogs, commercials on cable television, or a telecommunication or television shopping system. Ala. Admin. Code 810-6-2.90.03(1). The regulation became effective January 1, 2016. *See Newegg Inc. v. Alabama Department of Revenue, Ala. Tax Tribunal*, No. S. 16-613, appeal filed June 8, 2016).

[13] South Dakota under S.B. 106 required remote sellers with South Dakota sales exceeding $100,000 or 200 separate transactions per year to collect and remit tax.

[14] *Direct Marketing Association v. Brohl*, 12-1175 (10th Cir., Feb. 22, 2016, U.S. SCt, cert. denied Dec. 22, 2016). (See also *Direct Marketing v. Brohl and Advent of New Nexus Rules* for a complete analysis of the CO reporting requirements.)

[15] In New York, out-of-state sellers making taxable sales of tangible personal property or services are presumed to be sales tax vendors under specific conditions in which they have agreements with New York residents to compensate them for referring potential customers to the seller. And under select conditions, sellers of tangible personal property or services located outside New York that have an affiliate located in the state may also be required to register to collect and remit sales tax. *See* TSB-M-08(3) and TSB-M-08(3.1).

**Figure 2.**
**Federal Grants to State and Local Governments, 1980 to 2011**




*Source:* Congressional Budget Office based on Budget of the United States Government, Fiscal Year 2013: Historical Tables, Table 12.1.

### Expanding the Tax Base

In addition to expanding the number of retailers required to collect tax with broadened nexus, many states have increased the tax base on goods and services. The service sector's enormous growth and the U.S. manufacturing sector's corresponding decline have provided incentive for states to tax services. However, new or higher taxes on consumers or businesses are politically challenging for most legislators, particularly when the overwhelming majority of state sales and use tax provisions date back to the industrial age and are based on sales of tangible property.

State revenue officials have long advocated expanding the sales tax base to include sales of services (most notably, digital services) for reasons beyond generating new revenue, including:

- to track changing economic conditions;
- to fairly tax all consumers; and
- to simplify state administration and business compliance with sales tax requirements.

State administrators also argue that expanding the taxation of services can reduce sales tax enforcement and compliance costs.[16] Despite opposition to taxing services, there are examples of states and localities attempting to cast a wide net over taxable activities, including:

- Cloud computing.
- Denver taxes informational and entertainment services and software charges.
- Chicago determined that most cloud-based services — which provide access to information and database searches, word processing, calculations, or data processing — are taxable under the city's personal property lease transaction tax. Streaming services such as Netflix, Hulu, and Amazon would also be subject to this tax under the city's amusement tax.
- Texas and New York tax cloud computing, while nearly one-third of the states have not issued guidance on the taxability.
- Bundling of otherwise nontaxable with taxable activities

[16] *See* Michael Mazerov, "Expanding Sales Taxation of Services: Options and Issues," Center on Budget and Policy Priorities, Oct. 10, 2009.

- In 13 states labor charges are exempt if stated separately from material charges, but if the charges are not itemized, the entire service becomes taxable.
- Separately stated shipping charges (depending on the terms) are not taxable in many states. If you lump them into the price of goods or list the charges as shipping and handling, however, there is a good chance they are taxable.[17]
- Some states use the true object test to determine taxability when a good and a service is provided. For example, tax return preparation or medical testing will likely involve tangible personal property used in rendering a service.

### Increased Audit Activity

States are aggressively pursuing collection efforts through increased audit activities. Several, including Alabama and New York, recently announced plans to expand the resources devoted to the pursuit of taxing select activities.

- Examples of aggressive interpretation of what constitutes a taxable service include:
- Membership fees in a number of states have been deemed taxable if membership gives customers access to discounted prices. Who knew that having the right to shop was taxable? The South Carolina Department of Revenue has even determined that in some instances, membership fees related to the anticipated sales of tangible personal property are taxable.
- Connecticut taxes employee training, even if that training took place in another state. If your vendor sends you an invoice or contract that says tax is included, be prepared for the state to assess the tax in an audit if you cannot prove that your vendor paid the tax.
- In Texas, tax return preparation is considered a nontaxable professional service, but payroll processing is taxable as a data processing service.
- Examples of audits of exemption/resale certificates include:
  - There is additional scrutiny on certificates, including burdensome requirements for maintaining them. In some states, certificates expire.
  - Texas is one state where the courts have nearly done away with the good-faith exemption.

To illustrate one of the many sales tax challenges facing businesses, consider how a judge in Texas has added a heavy burden to companies obtaining certificates from customers.

To summarize Texas Tax Code section 151.054 (b) and (c): A sale is exempt if the seller receives a resale or exemption certificate in good faith from a purchaser. Sounds pretty simple in theory. The state's regulation 3.287 (d)(2) states: A sale is exempt if the exemption certificate is accepted in good faith at the time of the transaction and the seller lacks actual knowledge that the claimed exemption is invalid. Another requirement is that the seller must be familiar with the exemptions available for the items it sells. That sounds like a pretty straightforward situation for most companies. If your customer gives you a resale or exemption certificate that is completely filled out, the sale is exempt, right? You would think so. After all, the law is clearly written that way, not to mention there are penalties for issuing a certificate improperly.

In a recent Texas audit, a company that sold its products to retailers, manufacturers, governments or government contractors, and other businesses was challenged in its acceptance of certificates. In many instances, the certificates met every requirement under state law: They were obtained at the time of the sale and every portion of the certificate was completed. Despite these facts, the auditor denied a substantial portion of the certificates the company had received. The company knew its business and that the items it sold could be used in manufacturing, resold, or used by exempt entities, so why would

[17] *E.g.,* Massachusetts now includes charges for accidental damage and extended warranty contracts in the base of taxable tangible personable property unless separately stated (Mass. DOR Letter Ruling 16-3, 3/24/16). *See also Rent-A-Center East et al. v. South Carolina Department of Revenue*, No. 13-ALJ-17-0601-CC, Mar. 30, 2016, and *Alberici Constructor Inc. v. Director of Revenue*, Mo. S. Ct. 452 S.W.3d 632, (2015), holding that separately stated delivery charges were taxable.

they be denied? Some certificates were denied based on judicial determinations made in prior cases.

Specifically, in a 2014 hearing (201403900H), an administrative law judge decided that all requirements for certificates must be met, but added the following burdensome new requirement: "Moreover, the seller is responsible for generally knowing the type of business engaged in *by the purchaser* as shown on the resale certificate." The burden on the taxpayer changed from understanding the exemptions regarding its own business to having a general understanding of all its customers and how they would use the products sold in an exempt manner. The auditor, supervisor, and independent audit reviewer ignored the statutory and regulatory requirements for a taxpayer and followed what a judge decided because it resulted in more revenue to the state. It isn't always a matter of what is right or fair in state tax, but sometimes what the state can get away with. And with tight state budgets, businesses can expect more onerous burdens.

## Key Takeaways

Whether the Trump administration's entire budget wins congressional approval is yet to be seen. However, there can be no denying that funding domestic programs will be severely reduced, thus increasing pressure on state administrators to make up for anticipated revenue shortfalls.

### Diminishing Nexus Standard

For years state administrators aimed to minimize the impact of *Quill*, now outdated thanks to the explosion of the digital economy since it was rendered a quarter-century ago. Even Supreme Court justices acknowledge that federal legislation is needed to substantially reverse the physical presence standard.[18]

While the federal government seems unable or incapable of passing suitable legislation, states are taking matters into their own hands. They are imposing increasingly stricter rules requiring vendors who solicit sales within their borders to register and collect sales tax, or by requiring those not filing to collect and remit customer information, with penalties for not doing so. Accordingly, many businesses elect to collect the tax rather than risk penalties for noncompliance with reporting rules. When the largest retailer in the country, Amazon.com, surrenders and accepts the reporting and collection requirements in all 45 states (and the District of Columbia) that impose a state sales tax, is it time for the rest of the remote sellers to recognize their time has come, or will be coming shortly?[19]

States are no longer willing to forfeit collecting tax on an estimated $23 billion of digital goods and services.[20] Many well-intentioned retailers and their advisers may continue to attempt to limit states' powers to tax remote sellers with no presence in a state. However, while they *may* win the battle, states are likely to win the war. Amazon did not acquiesce because it wanted to be a good corporate citizen.

We advise remote sellers to prepare by instituting procedures — including purchasing software to begin collecting taxes on all goods and services that either are, or may become, subject to tax. As part of that process, sellers need to know what goods and services are taxable in each state. This can only be accomplished by initiating a state-by-state taxability matrix. Depending on the nature of the company's goods and service offerings, such an exercise can be either relatively straightforward or one that will require considerable time and resources to complete before starting the registration and collection process. Since navigating every state's rulemaking process can be arduous, with significant penalties for noncompliance, there is no time to waste. Seeking the advice of someone with multistate experience in these matters is prudent. The devil clearly is in the details and there is no universal answer in which one size fits all retailers.

[18] *See* concurring opinion rendered by Justice Kennedy in *Direct Marketing Association v. Colorado Department of Revenue*, 135 S. Ct. 1124 U.S. Mar. 3, 2015.

[19] Delaware, Montana, New Hampshire, and Oregon do not impose sales tax at the state or local level; Alaska does not impose a state sales tax, but a local tax may be imposed.

[20] Based on a University of Tennessee study and National Conference of State Legislatures estimates for 2012, current revenue losses are higher.

## The Digital Divide: Taxation of Services

Just as more states are deriving new and innovative means to limit *Quill*, they are equally passionate about taxing services — in particular digitally delivered services, which are the answer to their prayers to shore up deficits.

We have cited examples of states that already tax some form of goods or services delivered digitally. Over the next year we anticipate that more states will compel sellers of digital goods and services — with physical presence or not — to register and collect tax.

Taxpayers need to find those states where they derive major sources of revenue and review not only existing statutes, but also state administrators' pronouncements on what goods and services are taxable. In a rapidly changing environment, taxpayers can no longer depend on past practices or even past audit results to avoid state scrutiny.

States can also impose a duty on the seller to register and collect the tax, and if the vendor does not collect and remit the sales or use tax, it is the one bearing the ultimate obligation — plus interest and penalties, if applicable. These audits and assessments not only consume an inordinate amount of time and resources, but result in "above the line" charges which directly squeeze margins and earnings of many retailers that are already under extreme price and earnings pressure.

## Hope Is Not a Strategy

Burying your head in the sand or hoping you can avoid the audit lottery is not effective. It's time that businesses devote more time and resources to complying. Compliance need not be expensive; however, being assessed tax on sales at an average rate of 8 percent would cause most businesses serious hardship.

## Too Much of a Good Thing

While complying with state statutes and administrative mandates can ease potential liability for failure to register and collect sales tax, overcompliance is also a minefield.

The past decade has seen an alarming increase in class action lawsuits against vendors by consumers seeking refunds and damages for the overcollection of sales and use tax.[21] Correspondingly, companies that fail to properly collect tax on goods and services deemed taxable not only face the audit risk, but also the threat of whistleblower lawsuits initiated by disgruntled employees or other interested parties.[22]

Several recent settlements should give taxpayers pause. In one instance, Papa John's was the subject of two class action suits. The first one, in Florida, alleged that Papa John's unlawfully collected sales tax on $74.5 million of delivery charges (at rates of 6 percent to 7.55 percent), for more than $5 million in sales tax that was never owed nor should have been charged to customers. A settlement for an undisclosed amount was reached in 2015.[23] A second, similar suit was initiated in Illinois in 2016.[24] In both cases, the overcharged sales tax amounted to pennies per order but millions in the aggregate. In Illinois and Florida, sales tax is required to be imposed on delivery charges only if it is not separately stated on the invoice. On the other side of the ledger, one Illinois law firm reportedly filed more than 300 similar lawsuits under the False Claims Act as a whistleblower action against retailers that do not collect Illinois use tax on the shipping and handling charges associated with their internet or catalog sales.[25]

Companies can protect themselves from similar class action or *qui tam* whistleblower suits by carefully reviewing not only how all goods and services are taxed, but also how they are billed to customers.

Companies should periodically review certificates, rates, and taxability of goods and services both sold and purchased. Even with tax

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[21] M.C. Boch and L.A. Ferrante, "Damned If You Collect, Damned If You Don't," 24(7) *J. Multistate Tax'n & Incentives,* (Oct. 2014).

[22] *See* "State and Local Tax Collection Liability Customer Remedy Procedures," Multistate Tax Commission, July 12, 2013.

[23] *Schojan et al. v. Papa John's International Inc*. et al., U.S. District Court for the Middle District of Florida.

[24] The suit accuses Papa John's of violating the Illinois Consumer Fraud Act and Uniform Deceptive Trade Practices Act.

[25] See article by Hinman & Carmichael LLP at http://www.beveragelaw.com/booze-rules/2014/12/27/illinois-qui-tam-lawsuitsprivate-enforcement-of-a-state-claim-a-bonanza-for-a-plaintiffs-lawyer-and-a-rip-off-of-retailers. Since these cases were initiated, the majority of the suits were dismissed in the Illinois appellate court. *See also State of Illinois ex rel.Schad Diamond PC v. QVC and State of Illinois*, Appellate Court of Illinois, 1st District, No. 11L 8553 (2015).

decision software, changes in technology and business require periodic maintenance, and tax matrices can become outdated quickly if not maintained. Also, the tax department needs to work closely with the procurement and sales departments to implement policies to help avoid disastrous audits. Simple recommendations such as separately stating labor charges or always charging tax without a properly completed certificate (and a little extra scrutiny) can save a lot of money and headaches down the road. And if your company doesn't have a sophisticated tax group, many resources can help: Software packages, tax consultants, seminars, and other resources are available to assist almost any business in becoming more compliant. States are sending out their auditors and when you are selected, you'll be glad you have taken steps to improve compliance.

If after reviewing each company's facts and circumstances there remains doubt whether goods or services are subject to tax, as is often the case for companies delivering services or accessing information via the internet, then we highly recommend you seek guidance directly from the state or multiple jurisdictions. Often that information can be obtained anonymously — and more importantly can be used to refute any claim that the taxpayer has been acting in a fraudulent or deceptive manner when in fact it followed the state's advice.

## Summary

The Trump administration's budget proposal, which reduces state funding across multiple areas, gives states ample reason to expand their tax bases to more goods and services. Taxpayers, if not already frustrated by aggressive sales and use tax audits, can anticipate these enforcement tactics to grow over the next couple years. Having the flexibility to adapt existing policies and procedures in these volatile times will save an organization millions of dollars. Likewise, taxpayers must be vigilant when auditors' aggressive practices are not supported under the law or regulations, and choose which battles to fight.

Many years of experience in managing audits has taught us that there can be wide discrepancies between the statutes as enacted and how they are enforced by revenue agencies and their audit divisions. We also often witness inconsistent application of the law and underlying pronouncements among various taxpayers. Where one taxpayer may be assessed tax on a specific transaction or activity, another will be able to avoid an assessment on it. Hence, the level of planning, documentation, and the art of audit defense can make all the difference. Considering all states and administrative authorities will be eager to close increasing budget gaps brought on by federal spending reductions, there is no time to waste. ■