



Tips for Acing the Inevitable IRS Federal Excise Tax (FET) Exam

We may be in an era of lessening regulations, but the federal excise tax (FET) continues to badger heavy-duty truck and trailer dealers. The IRS has not relented in its FET examinations and related activity. IRS agents can come along any day and order an exam that scours your dealership for compliance weaknesses. Dealers would be wise to review your systems, personnel, and overall FET function to ensure you are compliant.

For some dealers, IRS exams have not been overly burdensome or punitive. But other dealers have had to exhaust human resources, endure some intense anxiety and stress, and very often write some large checks after an exam. Even if your intentions are honest and you never meant to violate any of the complex and muddy regulations, your innocent errors could cost you considerably in the assessment of tax, interest, and penalties.

Here are some simple and inexpensive suggestions to assist your dealership in being FET compliant and prepared when (not *if*) the IRS pays you a visit. These aren't exhaustive and don't offer a "silver bullet" remedy, but they should help position you well for a "clean" or "no change" exam result.

- **Include FET calculations in every deal file.** You need the calculations on every single deal to support the FET basis and show that FET that is being calculated and charged to the customer. Review your calculation template on a regular basis and make sure that no formula errors or hard coded numbers exist that could create discrepancies with the tax calculation.
- **Keep proper, current exemption certificates on file.** Keep exemption certificates in the deal file. Deals happen quickly, so take the time now to ensure proper support is documented. This saves you time and grief later when you can't remember why something was sold FET-exempt. In nearly every FET IRS exam, there is problem with at least one exemption certificate. These should be current (not expired) complete with signatures, dates, etc.
- **Create a deal file checklist.** Make a deal file checklist that will require those in the sales, operations, and accounting departments to sign off on the file to ensure requisite sales orders, invoices, FET calculations, exemption certificates, and other important details

are contained in the file before closing the deal.

- **Review relentlessly.** At least yearly, go back through each exempt sale and a sizeable sample of the taxable sales to ensure the deal files contain the correct documentation, accurate calculations, and valid exemption certificates. If your dealership does not have the discipline or resources for a project of this nature, consider hiring outside FET resources to assist. With a 12 percent penalty rate, finding just one incorrect deal and correcting the problem prior to an exam can pay for this exercise all by itself.
- **Double-check your marketing materials.** These materials should support the taxable and non-taxable sales positions that provide for FET exemption. Make sure each piece of collateral is consistent and does not contradict another. Selling exempt units to customers while your marketing materials support that the truck or trailer is taxable is a major problem. The IRS will request and review documents of this nature to validate your exempt sales. And don't forget to review your internet material, too. The IRS will generally always look at this information to find the specific uses for your equipment.
- **Constantly train your employees.** That long-time employee who knew FET rules like the back of his hand just quit. Does the new employee know the FET laws, or even know what FET is? Make sure all your employees are well trained and well versed in the complexities of FET. They should all understand and review sales invoices for FET accuracy. Cross-train your accounting personnel on FET to ensure smooth operations when vacations, sick days, and other absences arise.
- **Be consistent in FET protocol in all your locations.** Inconsistent application of the FET across multiple entities and locations causes concern with IRS examiners and can result in dire consequences for your dealership. If you have more than one location selling the same type of unit, make sure your procedures for FET calculations, exemptions, etc., are all the same at each place.
- **Don't mistake publications for law.** While Publication 501 on FET is widely used and is often referred to for FET in industry, it is **not** law nor should it be cited as such. We continue to see dealers refer to Publication 501 to support an exempt sale of a unit or part. Unfortunately, when they or the IRS dig into to actual law, they can sometimes arrive at a different answer. Dealers should rely on the actual code (IRC§ 4051), regulations, revenue rulings, and court cases to support your conclusions that something is taxable or not.
- **Don't model YOUR exempt sales after someone else's.** Don't rely on manufacturers, customers, or other dealers to determine your exempt sales. FET ultimately falls back to the seller when determining who should be charging, collecting, and remitting the requisite amount of tax. Some customers may try to "cheat" the system to save themselves tax. Other dealers may have aggressive approaches or interpretations of the law to get the sales.

Don't fall victim to these tactics. Know the laws. If your customer is adamant about the exempt status of something, push that burden of proof back to him; make him provide you with the guidance to support the exempt status. Remember, being aggressive in determining FET status causes *you* to pay the tax instead of the customer. And In some cases, the FET tax assessed may exceed the "gross profit" you received from the sale.

- **Thoroughly respond to information document requests (but don't go overboard).** Prior to an exam, the IRS will provide a formal letter outlining the periods and type of tax it will be auditing. There will be information document requests (IDRs) that specify documents, forms, and other information the IRS wants you to have available during its visit. While pulling this documentation, ensure that each deal file contains the necessary calculations, support, and documentation. Taking time to prepare and review these files prior to examination can avoid unnecessary delays or costly mistakes should the IRS find discrepancies or missing information before you do.

But don't provide more information than is specifically requested of you in an IDR. If additional documentation is needed, wait for the IRS agent to request it. Don't volunteer all files and unlimited access to information.

- **Don't get smug about your "clean" audit history.** Sailed through previous audits? Congratulations! Now get over it. This in no way should be relied upon as future audit protection. The next exam could focus on an entirely different issue or area. Since your last exam, you may have a new employee doing something incorrectly, or you may be selling a new unit or part not present in the past exam that is incorrectly being sold as exempt. Good past results are not guarantees of the same future results.
- **Get experts and allies on your side.** During an exam, have a representative (e.g. CPA or attorney) present who is familiar with the exam process, knows the documents to be signed during exam, and provides a buffer between you and your inspectors. Such insulation allows you to prepare the most accurate response to questions and can guard against quick, incorrect, or poorly thought out responses from your dealership's personnel. In short, if an agent has a question, it should be filtered through your representative prior to being answered.

These are some of the ways your dealerships can stay in compliance with FET laws and be ready for an IRS exam. If you have any questions or would like additional guidance or clarification on these suggestions, please contact Tim Reynolds at tim.reynolds@claconnect.com or at 913-491-6655 to learn more on how CliftonLarsonAllen can help.