



Connecticut Managed Compliance Program

Managed Audit Agreements
Managed Compliance Agreements
Direct Payment Permits

Creating Partnerships with Connecticut Businesses

MANAGED AUDIT AGREEMENTS

What is a managed audit?

A managed audit is a variation of the traditional field audit used by the Department of Revenue Services (DRS). During a managed audit, DRS provides the audit planning, direction, and scope, and the taxpayer provides the records retrieval and internal accounting expertise. This cooperative method of conducting the physical audit should save time for the taxpayer and DRS and ensure that the taxpayer pays no more or no less than the tax owed.

The managed audit concept grew out of the belief that the keys to voluntary compliance are taxpayer education and audit presence. The education is customized to fit the specific needs of a taxpayer's business. After the revenue examiner develops an audit plan, the taxpayer assumes responsibility for a portion of the audit examination.

Who qualifies for a managed audit?

An eligible taxpayer is any person who:

- Is required to file any return or to pay or remit any tax under Chapter 219, Sales and Use Taxes, of the Connecticut General Statutes;
- Has demonstrated a willingness and ability to comply with the tax laws of Connecticut; and
- Has maintained an acceptable system of business records.

At the discretion of DRS, qualification for participation in this program is based on the taxpayer's compliance history and internal controls and the anticipated time savings.

What are the benefits of a managed audit?

One outcome of the managed audit is a reduced presence of the revenue examiner at the taxpayer's place of business, providing the benefits of more flexibility and less disruption of the normal business day.

Through the managed audit process, the taxpayer will establish a personal contact within DRS. The revenue examiner on the managed audit should be viewed as a resource person whom the taxpayer can call with questions.

The managed audit increases the educational aspect of the audit process. A greater awareness of the sales and use tax laws and the taxpayer's own internal controls, strengths, and weaknesses is a beneficial by-product of the managed audit.

As an additional incentive to participate in the Managed Audit Program, Connecticut passed legislation which provides that up to the first \$10,000 of interest and 10% of the interest in excess of the first \$10,000 on the managed portion of the audit will not be imposed.

When the managed audit is completed, the taxpayer can be confident knowing any tax liabilities resulting from audit issues have been resolved for the audit period. All taxpayer rights are retained during the managed audit process.

What to expect in the managed audit

- 1. *The Agreement:*** The Managed Audit Agreement represents the taxpayer's willingness and commitment to participate in the managed audit process. Included in the agreement are the audit period(s) covered, the area(s) identified for potential liability, the records to be reviewed, the specific written procedures to follow to determine the tax liability, and a specific time frame for completion and payment.
- 2. *Time to Complete:*** The revenue examiner will establish a reasonable time frame agreeable to both the taxpayer and DRS. As a guideline, DRS expects the completion of the managed audit review and calculation of the tax within 30 days of signing the agreement.
- 3. *Forms:*** The revenue examiner and taxpayer will agree on the forms and format that the taxpayer will use. The taxpayer will provide the same type of information that is required on all audits. Either computer or manual spreadsheets may be used to provide this information.
- 4. *Verification:*** A key element to the success of the managed audit is the verification process. Revenue examiners are trained to develop a level of comfort with accepting the taxpayer's work with minimal, sufficient verification. The taxpayer is instructed to separate the records listed in workpapers until the verification process is completed. This allows direct access to the records included in the listings, as well as separate access to those records not included.

For More Information About Managed Audit Agreements

You may obtain additional information about the Managed Compliance Program from the DRS Audit Division, Sales Tax Subdivision, during business hours, Monday through Friday, at 860-541-7572. Information is also available on the DRS Web site at www.ct.gov/DRS

MANAGED COMPLIANCE AGREEMENTS

What is a Managed Compliance Agreement?

A Managed Compliance Agreement (MCA) is a formal written agreement between DRS and an eligible taxpayer that provides a method for calculating and remitting use tax on that taxpayer's purchases. An MCA is a cooperative agreement entered into at the discretion of DRS and may be customized by DRS to fit the needs of each taxpayer. An MCA allows each taxpayer to compute and remit use tax on aggregate purchases made during each filing period instead of computing and remitting use tax on a transaction-by-transaction basis. Under an MCA the taxpayer calculates and remits use tax by using one or more *effective use tax rates*.

What is an effective use tax rate?

An *effective use tax rate* is the rate of use tax to be applied against a predetermined base of purchases to compute an eligible taxpayer's use tax liability for a defined period. The effective use tax rate is determined by analyzing prior purchases made during a base period. A base period is a period representative of the taxpayer's normal purchasing activities. Statistical sampling, block sampling, a detailed review of purchases, or the results of a recently completed audit may be used to determine the effective use tax rate. The calculation of the effective use tax rate may be conducted by the taxpayer with DRS review.

The effective use tax rate is derived by calculating the ratio of taxable purchases to total purchases made during the base period and multiplying the ratio by the 6% use tax rate. Taxpayers may utilize a single effective use tax rate or use multiple effective use tax rates for different accounts or business segments to compute the use tax liability under an MCA. It is important that effective use tax rates accurately reflect the actual use tax liability of the business. A verification process is performed at the end of the term of the MCA to determine its accuracy.

Use tax computed by applying the effective use tax rate to applicable purchases under an MCA is reported on the monthly **Form OS-114, Sales and Use Tax Return**, along with other sales and use tax liabilities, if any. *Applicable purchases* means purchases of tangible personal property and services that fall within the scope of the MCA and are used or consumed in Connecticut.

Who is an eligible taxpayer?

An *eligible taxpayer* is a taxpayer required to file any return or to pay or remit any Connecticut sales or use taxes on its purchases. A taxpayer may be eligible for the MCA program only when, in the Commissioner's opinion, the taxpayer:

- Demonstrates a willingness and ability to comply with Connecticut tax laws;
- Maintains an acceptable system of internal controls and business records;
- Maintains a large volume of taxable purchases; and
- Cooperates with Connecticut's efforts to collect tax.

What is the application procedure?

The taxpayer must complete **Form AU-630**, *Managed Compliance Agreement Application*. Within 120 days from the postmark of the application, the Commissioner will review the application and send a response. The Commissioner retains sole discretion to approve or deny the application.

Is every taxpayer a potential candidate for an MCA?

DRS will not enter into an MCA with certain taxpayers. Taxpayers who will not be permitted to enter into MCAs include those that:

- Have failed to cooperate with DRS in the past;
- Have failed to remedy improper reporting habits;
- Have filed bankruptcy within the last ten years;
- Are controlled by or related to taxpayers who have filed for bankruptcy within the last ten years;
- Have been or currently are the subject of ongoing criminal investigations;
- Maintain poor internal controls;
- Maintain an unacceptable system of business records; or
- Do not have a large volume of taxable purchases.

What are the benefits of entering into an MCA?

The potential benefits of an MCA for the taxpayer include:

- Predictability and consistency of approach in tax reporting;
- Decisions regarding tax compliance made by in-house and outside tax experts as opposed to non-tax personnel;
- Focus on business issues rather than tax compliance and audit concerns;
- Reduced likelihood of detailed, lengthy sales and use tax audits;
- Potential elimination of audit penalties;
- Reduced audit, litigation, and refund review expenses;
- Increased accuracy in use tax budgeting and more certainty and consistency of use tax expenses; and
- Development of cooperative relationship with DRS.

The potential benefits of MCAs for DRS include:

- Reduced audit costs;
- Increased confidence in reported tax;
- Redirection of audit staff to taxpayers who otherwise might not be audited;
- Higher overall taxpayer compliance;
- Improved taxpayer relations;
- Timely receipt of use taxes; and
- Development of cooperative relationships with taxpayers.

What is provided in an MCA?

MCAs are individualized for each taxpayer. However, all agreements contain the following:

- A determination of the base period and applicable purchases;
- One or more effective use tax rates;
- A method to reconcile the effective use tax rate with the taxpayer's actual use tax liability;
- A term of three years or less (Although an agreement may be no longer than three years, DRS may enter into subsequent agreements with the same taxpayers.);
- The conditions under which the agreement may require modification or termination; and
- Other mutually agreed upon provisions.

What is a direct payment permit?

A direct payment permit allows a taxpayer to pay use tax on its purchases directly to DRS instead of paying sales tax to a vendor. The direct payment permit holder uses the permit to make most purchases without payment of sales tax. The direct payment permit holder self-assesses use tax on taxable purchases and remits the use tax with its sales and use tax returns.

How does a direct payment permit work with an MCA?

MCAs work best in conjunction with direct payment permits. Since purchases that fall within the scope of the MCA are purchased without tax, the use tax liability is calculated by applying the effective use tax rate to the aggregate costs of these purchases made during the filing period.

Are all purchases a taxpayer makes usually included in an MCA?

Large volume purchases of taxable goods and services a business makes for its own use on an ongoing basis are generally included in an MCA. Capital asset purchases may be included in an MCA. The following types of purchases are always excluded from an MCA.

- Tangible personal property incorporated into new construction of real property;
- Resale and inventory purchases;
- Utility services (gas, electric, and heating fuel);
- Telecommunications services;
- Meals and lodging;
- Motor vehicles, vessels, aircraft, and snowmobiles;
- Purchases where DRS and the taxpayer do not agree on the taxability;
- Purchases made with Procurement Cards (P-Cards); and
- Tangible personal property consumed or incorporated in the installation, maintenance, and repair of utility mains, lines, poles, pipes, and other facilities located within a public right-of-way.

Is there a verification process for MCAs?

A *true-up* is conducted at the end of each MCA. A true-up is a reconciliation conducted at the end of the MCA to determine if the amount of use tax reported for purchases accurately reflects the taxpayer's actual use tax liability. The true-up or verification process involves reviewing procedures and sampling transactions that occurred during the term of the agreement. The verification process may be conducted by the taxpayer and DRS using managed audit techniques.

What happens if a business operation has a material change or there is a change in tax laws that affect the business?

MCA conditions require an agreement to be modified or terminated if there is a material change. The MCA defines what constitutes a material change. Examples that may create a material change to a business are:

- Significant changes involving business activities outsourced or transferred;
- Significant starting up or closing of facilities;
- Merger or acquisition;
- Adoption of cost containment programs; or
- Significant financial or accounting changes.

A legislative change to the sales and use tax statutes may also require an MCA to be modified.

The taxpayer has the responsibility to notify DRS of a material change. DRS may terminate an MCA and conduct an audit if the taxpayer fails to fulfill any term of the agreement and the failure is materially adverse to DRS. DRS may give 30 days written notice to the taxpayer to remedy the situation, if DRS believes the failure is capable of being remedied, before terminating the MCA. If the failure is not remedied, the MCA will be terminated on the first day of the fourth month following the month in which notice of termination is given by DRS. However, DRS may terminate an MCA immediately without giving 30 days notice to remedy the failure if it has reason to believe collection of any tax required to be collected and paid to the state or any assessment will be jeopardized by delay.

What is the method to reconcile an MCA?

A key element of an MCA is the reconciliation of the effective use tax rate with the taxpayer's actual liability. DRS and the taxpayer agree to waive amounts of tax due or tax refund claims if these amounts fall within the acceptable range DRS applies to all taxpayers entering into MCAs. The acceptable range is within .5% (.005) of the actual use tax liability. However, the acceptable range may be changed on a prospective basis for MCAs entered into after the effective date of an announced change of a tax rate or on a retroactive basis for MCAs existing on the effective date of the announced change, upon agreement by DRS and the eligible taxpayer.

May a taxpayer request a use tax refund for applicable purchases that fall under an MCA during the term of the agreement?

Overpayments on purchases that are part of an MCA are examined during the verification process. A taxpayer that has entered into an MCA is not allowed to file a claim for refund of use tax from DRS or vendors on any purchases of goods or services included in the MCA during the term of the agreement. However, there is an exception. If a taxpayer holds a direct payment permit and enters into an MCA and erroneously pays tax to a vendor on a purchase that must be made using the direct payment permit, the taxpayer may request a refund of tax from the vendor or DRS.

Does a taxpayer have other rights under an MCA?

The Connecticut Taxpayer Bill of Rights applies to all taxpayers, including those under an MCA. A taxpayer with an MCA has rights to informal audit conferences, oral hearings to petition for reassessment, and the court system. Accordingly, the taxpayer may protest or appeal any disputes about the taxability of goods or services that arise during the verification process.

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DIRECT PAYMENT PERMITS

What is a direct payment permit?

Traditionally, businesses pay sales tax to their vendors when purchasing taxable goods or services. The vendors then remit the tax to DRS by filing sales and use tax returns. However, the taxability of purchases by certain businesses may not always be determinable at the time of the transaction. For instance, purchases of certain items by a manufacturing company may be taxable at 6% or 3% or totally exempt from tax. A determination of the proper rate of tax depends on the type of item purchased and how and where the manufacturer will use it. To help simplify this complex tax situation, a direct payment permit allows a business to purchase taxable goods and services without paying tax to the vendor and to remit the correct use tax directly to DRS. This process allows businesses the necessary time to accurately determine how much tax to assess on their purchases.

Who qualifies to use a direct payment permit?

Taxpayers interested in applying for a direct payment permit must meet all of the following criteria:

- The collection of sales and use taxes will not be jeopardized if a direct payment permit is issued;
- The business's accounting system will clearly indicate the amount of sales and use taxes owed;
- The business is regularly audited by DRS;
- The business will remit sales and use taxes using Electronic Funds Transfers (EFT) technology; and
- The business agrees that its name may be published as a direct payment permit holder on the DRS Web site and in any other related publication.

What is the application procedure?

The taxpayer must complete **Form AU-620, *Direct Payment Permit Application***, and remit the \$20 permit fee to DRS. Within 120 days from the postmark date of Form AU-620, the taxpayer will be sent a letter of approval or denial. The 120 days will be extended if the taxpayer chooses to receive the direct payment permit only if approved for a Managed Compliance Agreement. In that case, DRS will notify the taxpayer of the decision to approve or deny the direct payment permit when the taxpayer is approved or denied for the Managed Compliance Agreement. The Commissioner retains sole discretion in the approval, denial, and revocation of direct payment permits.

What procedures must a direct payment permit holder follow?

The qualifying taxpayer must purchase all goods and services without paying Connecticut sales and use taxes, except those specifically listed. The direct payment permit holder must provide the retailer with a copy of the direct payment permit at the time of each purchase or it can issue a blanket copy of its direct payment permit for those purchases similar in type and of a recurring nature.

What purchases are not allowed with a direct payment permit?

- Tangible personal property incorporated into new construction to real property;
- Meals or lodging;
- Motor vehicles, vessels, aircraft, and snowmobiles;
- Telecommunications services;
- Utilities (gas, electricity, and heating fuel);
- Purchases made with Procurement Cards (P-Cards); and
- Tangible personal property consumed or incorporated in the installation, maintenance, and repair of utility mains, lines, poles, pipes, and other facilities located within a public right-of-way.

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Appendix

Form AU-587, *Managed Audit Application*

Form AU-620, *Direct Payment Permit Application*

Form AU-630, *Managed Compliance Agreement Application*

For Further Information

Please call DRS during business hours, Monday through Friday, for more information about the Managed Compliance Program:

1-800-382-9463 (in-state) or

1-860-297-5962 (from anywhere)

or visit the DRS Web site at www.ct.gov/DRS



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