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2025 Tax Conference

“Build Tax Better”

Sales Tax Audits-
A Deeper Dive

By:
Clinton
Singletary



A Deeper Dive into Sales Tax Audits

Sales Tax Audit Considerations

This session will address the following topics:

1. Audit Selection
 - Who & How to select
2. Frequency of Audits
 - How often audits can be conducted
3. Conducting an Audit
 - Basic flow and how to close out an audit
4. When / How to use audits
 - What should your goal be in an audit?

Audit Selection

There are three primary methods of selecting an audit candidate:

1. Analytics-based

- Selection based on trends or red flags in reporting

2. Industry-based

- Focus on auditing a single group of similar businesses

3. Cyclical selection

- Auditing businesses in regular intervals

Analytics Based Selection

Most common way to select an audit but is dependent on your recordkeeping and ability to analyze the reported data.

- Look for sudden, out of trend increases or decreases.
 - Either Gross Sales or exempt sales could be out of trend.
 - A sudden change out of trend may signal that prior filings were erroneous.
 - Is best to look at long term trends for the business, to see if there are seasonal or other regular fluctuations in their reported sales.
- Review reported exempt sales for questionable claims.
 - Check for businesses uncommon exemptions to see if businesses claiming the exemption(s) are a good fit.
 - Focus on high % exempt reporting
 - Look generally at reported exemptions that don't make sense for a particular business to claim.

Industry Based Selection

This method tends to be better received than other methods of selection but can be less productive depending on the industry.

- Select an industry in which multiple businesses are operating. For example:
 - Tour companies, contractors, leasing/rental companies, restaurants
 - Exemption-based audits on several big box stores
- Auditing “competitors” at the same time helps promote a sense of fairness.
- May also find common reporting errors across the industry that needs to be addressed at a broader level such as official guidance or code clarification.
- This method isn’t as likely to generate an assessment as an analytics-based approach would, but there is still overall value in checking to see how well the industry overall is following your code.

Cyclical Selection

This method is best used in a limited manner, to check up on previously audited businesses.

- In a perfect world, every business in your community would be audited at least once within your statute of limitations.
- This is generally not achievable due to limited audit staff, and the number of businesses that exist in most communities.
- Not as effective as other audit methods, as most businesses will remedy issues encountered in an audit.
- This method is best used if you have a problematic business with an overall bad system of recordkeeping and exemption documentation.
- Best to audit these problem businesses every other year until they can show that the needed corrections have been made.

Conducting an audit

There are five distinct steps to conducting an audit:

1. Notification to business

- Giving sufficient notice business to provide requested documents
- At least 30 days notice is recommended

2. Initial contact / audit interview

- Good practice to meet with business at the outset of audit to discuss their accounting and documentation methodology
- Also discuss audit methodology, such as selected period and determining audit assessment

3. Receipt of documentation

- Best to request either physical or electronic copies of documents.
- Don't want to place their original documents at risk of damage, and documents should be retained in audit file.

4. Review of documentation

- Review provided docs to verify accuracy and proper application of tax code, including exempt sales.

5. Audit findings

- Seller should be provided audit findings in writing, with opportunity to protest or provide additional documentation before finalizing.

Conducting an audit

Calculating an audit assessment

- Pick sample period that is representative of seller's activity.
- If exemptions are a concern, ensure that sample period includes all normally claimed exemption categories.
- The sample period will be used to determine an error margin, if any errors are found.
 - Error margin is simply the rate of error in the seller's reporting.
- By picking a representative period, the error margin can be applied to the remaining reporting periods within statute of limitations.
- Error margin "extrapolation" based on a sample period is a common and accepted method of conducting sales tax audits and helps streamline the audit process.

THANK YOU



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