Avalara

Use Tax for Manufacturers:

What Your AP Team Doesn't Know Could Cost You

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Meet our speakers

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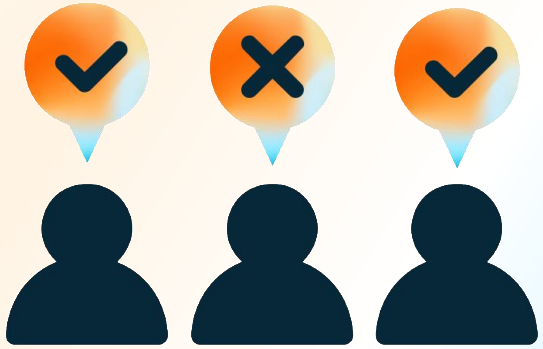
Agenda

1. How manufacturing operations are inherently complex
2. Why use tax is uniquely complex for manufacturing
3. Operational triggers and audit red flags
4. Strategies to achieve compliance & mitigate risk
5. Key takeaways and Q&A

01

CPE POLL QUESTION



Has your organization undergone a state sales and use tax audit within the past 3 to 5 years?

A	Yes – and consumer use tax on purchases was the primary focus.
B	Yes – and customer exemption certificates was the primary focus.
C	No – but we are currently preparing for an upcoming audit.
D	No – we have not been audited.
E	Unsure / Not involved in tax audits.

How manufacturing operations are inherently complex

The Complexity Baseline

Sourcing, production, and procurement create a shifting web of tax obligations across multiple jurisdictions.

High-Volume, Multicategory Purchasing:

Sourcing spans raw materials, heavy plant machinery, safety gear, and thousands of monthly Maintenance, Repair, and Operations line items.

Decentralized Physical Footprint:

Moving equipment, work-in-progress, and inventory between plants across state borders triggers distinct tax situs and self-assessment events.

State Complexity:

Taxability isn't universal; what is exempt in an "integrated-plant" state may be 100% taxable in a "direct-use" state.

The Accounts Payable Disconnect

Why relying on manual AP workflows and vendor invoices creates systemic compliance blind spots

The Invoice Trap

Out-of-state vendors frequently fail to charge sales tax due to lack of nexus—shifting the legal burden of use tax self-assessment entirely onto the buyer.

The "State Tax Expert" Expectation

AP personnel are experts at invoice matching and payment velocity, not multi-state taxation across nuanced commodity codes.

The Risks of Static Systems:

Standard ERP lookup tables and spreadsheets cannot evaluate context—such as whether a replacement motor is for an exempt assembly line or a taxable shipping dock

The Cost of Non-Compliance: Audit Exposure & Cash Leakage

The #1 Audit Liability

- According to SALT practitioners, unaccrued consumer use tax on procurement and equipment is consistently the single largest liability uncovered in manufacturing audits.

Compounding Financial Penalties

- State audit assessments reach back 3-4 years, compounding baseline tax debts with penalties (10%-30%+) and statutory interest.

The Dual Exposure

- Non-compliance isn't just about underpaying; manufacturers silently leak millions by overpaying sales tax to suppliers who improperly charge tax on exempt production equipment and materials.

Ongoing Audits and Corrective Action

- Failure to implement corrective controls following an audit transforms routine compliance errors into actionable negligence, exposing the business to statutory disregard penalties

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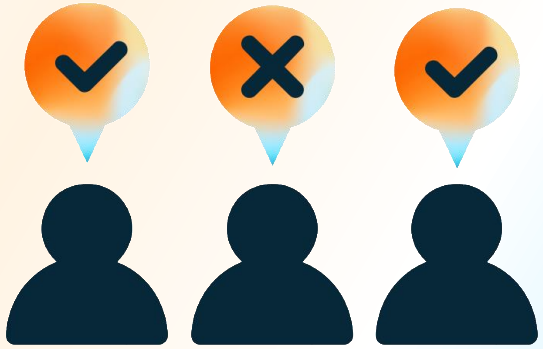
02

CPE POLL QUESTION



How does your organization currently evaluate incoming vendor invoices for sales and use tax accuracy?

A	We rely primarily on our vendors to calculate and charge the correct tax.
B	Accounting/Tax conducts manual reviews and sample spot-checks on select invoices.
C	We have an automated tax compliance solution that evaluates line items.
D	Unsure / Not currently monitored.

Why use tax is uniquely complex for manufacturing

An Overview of Use Tax for Manufacturing

Defining the buyer's obligation and why manufacturing spend makes compliance uniquely difficult.

SALES TAX (SELLER-COLLECTED)

- Calculated and billed by vendor
- Applies at point of sale
- Outbound revenue transactions

CONSUMER USE TAX (BUYER-OWED)

- Self-assessed & remitted by buyer
- Triggered when vendor fails to bill
- Inbound procurement & plant spend

WHY IT GETS COMPLICATED IN MANUFACTURING

High-Volume Spend + Multi-Facility Footprints + Nuanced State Exemption Rules

Why Use Tax Is Uniquely Complex for Manufacturing

Three structural factors that turn everyday industrial purchasing into a high-risk compliance challenge.

The Jurisdictional Exemption Maze

- **"Manufacturing" Definition** in state statutes - where it begins and where it ends. And how the equipment used may or may not qualify for an exemption.
- **Direct Use Standards** - By knowing the Manufacturing definition, the taxability of the equipment will be determined
- **Direct Pay Permits:** All services and materials purchased as tax exempt and required to self-assess consume use tax on taxable spend.

Dual-Use Inventory & Context-Driven Taxability

- **Taxability Depends on Where & How It Is Used:** An identical component (e.g. gloves or goggles) is **tax-exempt** when used by machinery operators, but **fully taxable** when used for landscaping around the plant.
- **Inventory Diversion Triggers:** Raw materials purchased tax-free that are later consumed internally for plant upkeep generally immediately trigger a use tax self-accrual obligation.

The AP Knowledge & Systems Gap

- **Invoices Lack Critical Operational Context:** Out-of-state vendors do not know the end-use of an item or may lack nexus, shifting the full burden of tax determination onto the buyer.
- **AP Forced to Act as Tax Experts:** AP specialists are measured on processing speed and payment accuracy not tax accuracy,
- **Static ERP Rules Cannot Keep Up:** Traditional ERP have limited or no use tax functionality.

The Consequences of Non-Compliance

Why indirect tax errors in manufacturing create compounding financial exposure and silent cash leakage.

Severe Audit Assessments & Compounding Penalties

- **The Single Largest Audit Risk:** According to SALT practitioners, unaccrued consumer use tax on procurement and equipment is consistently the **single largest liability uncovered** in manufacturing state tax audits.
- **Multi-Year Financial Compounding:** State auditors examine 3 to 4 years of historical purchase data. Cumulative underpayments are multiplied by penalties (typically **10% to 30% or more**) plus statutory interest.

Silent Cash Leakage (Unrecovered Overpayments)

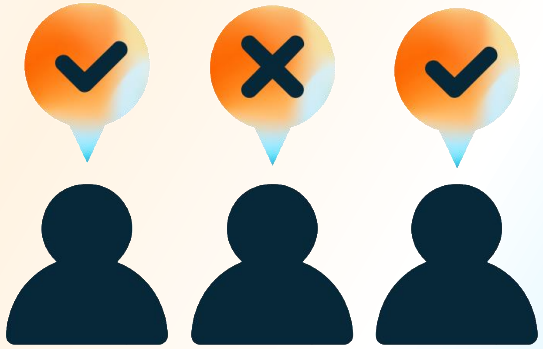
- **Paying Tax on Tax-Exempt Purchases:** Suppliers do not know the intended use of purchased material and equipment which can lead to a tax overpayment.
- **The Recovery Burden Lies Entirely on the Buyer:** The process of recapturing over paid tax is cumbersome.

Operational Resource Drain & Cascading Scrutiny

- **Heavy Administrative Burden:** Manufacturing accounting teams spend an average of **140+ hours per month** manually reviewing invoices, managing exemption certificates, and pulling audit records.
- **Tax Refund Processes:** Amending returns, buyers claim for refunds, reaching out to vendor directly, and the risk of triggering an audit.

03

CPE POLL QUESTION



Which spend category or operational trigger represents your organization's highest use tax audit concern?

A High-volume Maintenance, Repair & Operations purchases.

B Raw materials

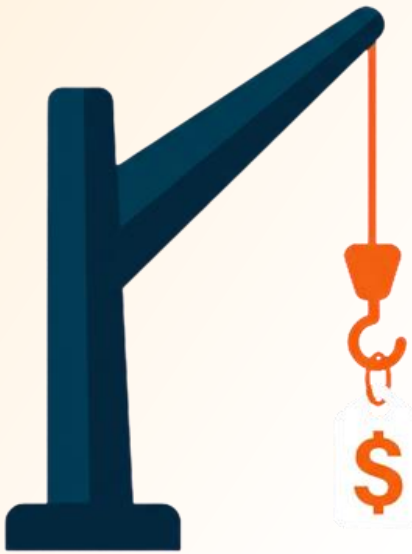
C Capital equipment purchases

D Direct Pay Permit tracking and self-assessment compliance.

E Missing vendor exemption certificates.

Operational triggers and audit red flags

Big-ticket machinery purchases carry high-stakes tax classification and bundled fee rules.



Capital Equipment, Delivery & Installation

Statutory Qualification Nuances: While production machinery is often exempt, items like cranes, forklifts, conveyer systems, and foundation supports may not be used directly in manufacturing and are taxable spend.

Fixed Asset Risks: Manufactures frequently bundle taxable installation, custom calibration, freight, or software licenses into a single fixed asset.

High Individual Dollar Exposure: Because capital equipment invoices run into the hundreds of thousands or millions of dollars, a single miscalculated tax rate or missing exemption certificate can result in an audit assessment.

Specialized compliance permits shift total tax responsibility to internal teams.

Direct Pay Permits

Direct Pay Permit Authority: Operating under a Direct Pay Permit relieves vendors from charging tax, putting **100% of the burden on the manufacturer** to calculate and remit use tax on every eligible purchase.

Auditor Scrutiny: State Departments of Revenue place direct pay permit holders on accelerated audit schedules, specifically examining whether internal tracking mechanisms capture every taxable transaction.

Strategies to achieve compliance & mitigate risk

Mitigating Risk – Audit Defense & Voluntary Disclosures

Proactive strategies to remediate historical liabilities and establish defensible internal controls.

Remediating Historical Exposure with VDAs:

For manufacturers with multi-state unaccrued use tax, Voluntary Disclosure Agreements (VDAs) allow companies to come forward anonymously, **capping lookback periods** and **waiving 100% of penalty assessments**.

Building a Defensible Audit Trail:

State auditors target disorganized records. Having centralized, searchable documentation demonstrating a consistent, documented tax evaluation process significantly reduces auditor scrutiny.

Conducting Reverse Audits:

Proactively auditing purchase history recovers cash from vendors who improperly charged sales tax on exempt machinery and supplies, creating cash offsets against potential liabilities.

Intelligent Automation – AI-Driven Use Tax Management

Replacing manual AP guesswork and static ERP lookup tables with real-time, line-item intelligence.

Context-Aware Line-Item Evaluation:

Unlike static ERP tables that only look at GL codes, AI agents dynamically evaluate unstructured invoice descriptions, commodity types, and plant-level use cases.

Automated Over/Under Detection:

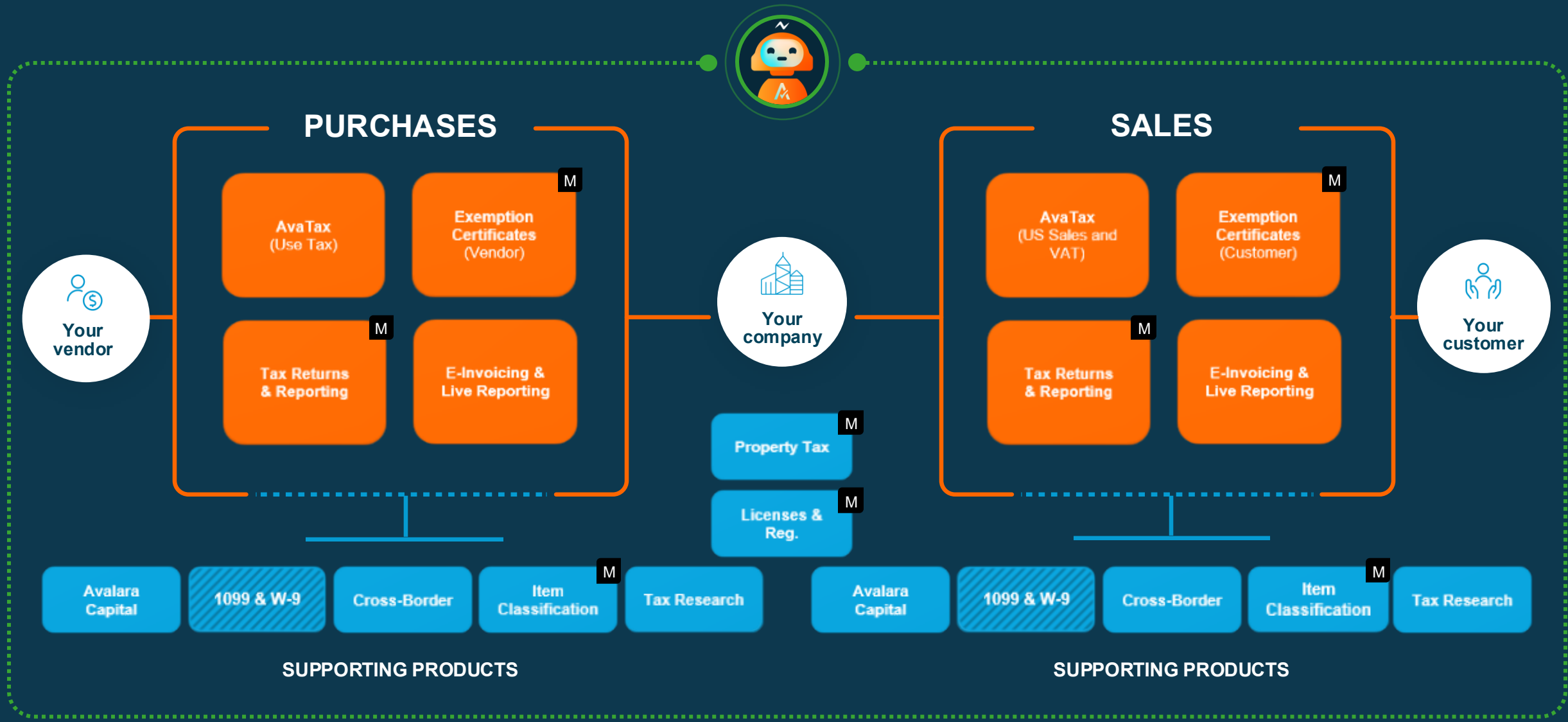
Invoices with vendor overcharges are immediately flagged for correction or credit requests, while under-billed transactions trigger automatic use tax self-accruals.

Continuous Learning & Adaptation:

AI models adapt to changing purchasing patterns, shifting state direct-use rules, and multi-facility transfers without requiring constant IT reconfiguration.

Avalara products and services ›

AI-powered order-to-cash (sales) and procure-to-pay (purchases) compliance workflows



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Key Takeaways

Key Takeaways: Mastering Manufacturing Use Tax

Transforming buy-side tax compliance from a hidden liability into an automated, margin-protecting process.

Use Tax Is the #1 Audit Liability for Manufacturers

High purchasing volume makes manufacturing a prime target for state audits, where unaccrued use tax on vendor invoices consistently ranks as the largest assessment owed.

Context and Geography Dictate Taxability

Taxability depends on how, where, and when an item is used. Dual-use inventory and conflicting "direct-use" vs. "integrated-plant" statutes make manual classification impossible at scale.

Manual AP Processes Cause a Dual Financial Hit

Relying on vendor invoices and static ERP tables leads to both under-accruing liabilities (triggering 10%–30% penalties) and overpaying sales tax on exempt purchases (eroding operating margins).

Intelligent Automation Eliminates Guesswork

AI-powered solutions parse unstructured invoice line items, dynamically cross-checking vendor-billed tax against real-time rules to flag overcharges and auto-accrue underpayments.

Integrated Compliance Delivers Measurable ROI

Connecting AvaTax for AP, Avalara Tax Research, ECM/VEM, and Managed Returns eliminates up to 90% of manual tax workload, recovers thousands in overpaid tax, and provides audit-ready defense.

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CPE POLL QUESTION

Which best describes your organization's plans for automating accounts payable use tax and compliance?

A	Currently evaluating solutions
B	Interested in automation, but no plans currently
C	Already using an automated solution
D	Managing manually with no immediate plans to change
E	Unsure, not involved in systems planning

LEARN MORE/CONTACT US:

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