

## SELF-AUDIT PROGRAM: FAQs

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*To provide guidance to taxpayers and their advisers, the Division of Taxation has drafted the following answers to frequently asked questions (FAQs) about the new self-audit program, which is managed by the Division of Taxation. This document is for general information purposes only and is not a substitute for Rhode Island General Laws or Division of Taxation regulations or formal rulings.*

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### OVERVIEW

**Q: What is a self-audit?**

A: You perform an audit of your books and records to see if you owe Rhode Island's 7 percent use tax. You then submit the results of your audit, along with payment for the tax due, to the Rhode Island Division of Taxation.<sup>1</sup>

**Q: How do I benefit?**

A: If your self-audit meets all of the program's requirements and is approved by the Tax Division, and you pay the tax due, the Tax Division will waive all penalties – and forgive two-thirds of the interest.<sup>2</sup> Furthermore, the Tax Division will agree not to audit you for the period and tax type involved in your self-audit.<sup>3</sup>

**Example # 1**

In mid-November 2015, Alpha Corp. applies for, and is accepted into, the self-audit program managed by the Tax Division. Alpha then examines its own books and records – covering the 36-month period of October 2012 through September 2015 – to determine if it owes use tax and finds that it does. Alpha completes the self-audit in accordance with all of the program's requirements – the self-audit is finished on time, the tax is paid on time,

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<sup>1</sup> The Rhode Island Division of Taxation is also referred to in these FAQs as “the Tax Division”.

<sup>2</sup> The Tax Division will waive two-thirds of the interest if the applicant completes the self-audit within the allotted time, the results are accurate, and no additional documentation or information is needed. Otherwise, the Tax Division may waive one-third of the interest.

<sup>3</sup> The benefits apply if neither the self-audit nor the information reviewed by the Tax Division discloses fraud or willful evasion of tax.

the self-audit results are accurate, and no additional information or documentation is needed. As a result, the Tax Division waives all penalties, forgives two-thirds of the interest, and will not audit Alpha for use tax for the 36-month period of October 2012 through September 2015.<sup>4</sup> (If Alpha fails to meet one or more of the program’s requirements, Alpha may still be eligible for all of the program’s benefits, but when it comes to interest, the Tax Division will forgive no more than one-third.)

**Q: Is there any oversight of the self-audit?**

A: Yes. The Tax Division oversees each self-audit, from application to completion. If someone’s application for the program is approved, a revenue agent is assigned to guide the taxpayer through the process. (The revenue agent will typically be stationed at the Tax Division office in Providence, but will be available to answer the taxpayer’s questions, usually by phone or email.) In addition, the Tax Division has the right:

- to approve or reject your application for the program;
- to approve or reject the results of your self-audit;
- to ask you for additional documentation; and
- to conduct a physical inspection of your place of business to verify the accuracy of your self-audit.

In summary, although it is a self-audit, it is done under the guidance, monitoring, and oversight of the Rhode Island Division of Taxation.<sup>5</sup>

At a glance: Benefits of self-audit program	
<i>If all of the following requirements are met...</i>	<i>the Tax Division will ...</i>
• you complete the self-audit on time;	• waive all penalties;
• you pay the correct amount of tax on time;	• levy 6% interest per year instead of 18%*;
• the self-audit results are accurate; and	• agree not to audit you for tax type and period.**
• no additional information, documents needed	
* If you do not meet all of the requirements above, but the Tax Division determines that you are still eligible for the program’s benefits, interest will be 12% per year instead of 18%.	
** The agreement is only for the tax type and period involved in the self-audit.	

**WHO IS ELIGIBLE?**

**Q: Is the self-audit program open to businesses only?**

A: It is open to businesses and individuals.

<sup>4</sup> The names of corporations or other entities used in examples in these FAQs are not intended to represent the names of actual businesses.

<sup>5</sup> The statute that governs the program, Rhode Island General Laws (RIGL) § 44-19-43, uses the term “managed audit” instead of “self-audit”.

**Q: Is the program for all tax types?**

A: For now, it is only for the use tax. Eventually, the program may be broadened to include the sales tax. The Tax Division will make an official announcement regarding any expansion of the program.

**Q: Is the program for all taxpayers?**

A: For now, sales tax permit holders are excluded from the program. Thus, retailers are not eligible due to the potential complexity involved (retailers typically collect sales tax but pay use tax). Put another way, the program, for now, is open only to non-retailers – that is, only to those that do not have a Rhode Island sales tax permit. Eventually, however, all taxpayers – including retailers – may be eligible, and the program may be expanded to include sales tax. The Division of Taxation will make a formal announcement regarding any expansion of the program.

**Q: Is this program open only to residents?**

A: It is open to residents and nonresidents, business and individuals. However, as a general rule, nonresident businesses and individuals should first determine whether a separate program, the Voluntary Disclosure Program, may be better suited to them. More information is on the program website: [http://www.tax.ri.gov/misc/voluntary\\_disclosure.php](http://www.tax.ri.gov/misc/voluntary_disclosure.php)

**Q: Is anybody else not eligible for the self-audit program managed by the Tax Division?**

A: You are not eligible if any of the following apply:

- you hold a Rhode Island sales tax permit;
- you are under audit now by the Tax Division;
- you have been audited by the Tax Division within the five-year period immediately preceding your application;
- you have an appeal pending involving a Tax Division matter; or
- you have been in federal bankruptcy or state receivership proceedings.

## TAX TYPE

**Q: Why is the program open only to the use tax for now?**

A: Legislation authorizing the program was enacted only recently.<sup>6</sup> The Tax Division continues to work on implementing it. So, for now, the program is limited to the use tax.

**Q: What is a use tax?**

A: If you buy a taxable item without paying sales tax, you owe the 7 percent use tax.<sup>7</sup> For example, if you buy a laptop computer online and no sales tax is collected on that purchase, you owe Rhode Island's 7 percent use tax. The tax is due on the sales price – including all services necessary to make the sale (such as maintenance and delivery charges).

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<sup>6</sup> House Bill 5900 Substitute A as amended, art. 11, § 9, to be codified at RIGL § 44-19-43.

<sup>7</sup> See RIGL § 44-18-20.

The tax rate is the same for both the sales tax and the use tax and the exemptions are the same, too. Sellers collect Rhode Island sales tax and pay it over to the Tax Division, whereas the use tax is self-assessed – it is paid by the purchaser, the end user, directly to the Tax Division.

**At a glance: Examples of businesses that may owe use tax**

- A law firm buys or leases a copy machine – and no Rhode Island sales tax is charged.
- An accounting firm buys or leases software – and no Rhode Island sales tax is charged.
- A dentist’s office buys or leases computer hardware – and no Rhode Island sales tax is charged.
- A machine shop buys office supplies online – and no Rhode Island sales is charged.

**Q: Could you provide some detailed examples of businesses that owe use tax but may not be aware of it?**

A: Following are some detailed examples:

**Example # 2**

ABC Law Firm bought \$10,000 in office equipment and related supplies from an out-of-state vendor online, through a catalog, or via a toll-free number. The out-of-state vendor charged no sales tax. ABC Law Firm owes Rhode Island’s 7 percent use tax on the office equipment and related supplies. In this example, the tax is \$700.

**Example # 3**

DEF Dental, a dentist’s office, bought a large-size TV screen for its waiting room as well as dental equipment to examine its patients. The TV screen and the equipment were purchased for a combined total of \$2,500 from an out-of-state vendor, which charged no sales tax. DEF Dental owes Rhode Island’s 7 percent use tax. In this example, the tax is \$175.

**Example # 4**

GHI Insurance downloaded prewritten software for use in its business. No sales tax was charged by the vendor on the price of \$5,000. GHI Insurance owes Rhode Island’s 7 percent use tax. In this example, the tax is \$350. [That is the case even if the prewritten software is specific to the insurance industry. However, if it is truly customized software, no tax is due. “Customized” essentially means software that is created and written expressly for you and nobody else.]

### Example # 5

JKL Contracting bought \$17,000 in equipment that it uses in the performance of a contract. JKL purchased the equipment from a store in Massachusetts, which charged sales tax at a rate of 6.25 percent, for a total of \$1,062.50. JKL paid no Rhode Island sales tax on the equipment. In this example, JKL owes \$127.50 in Rhode Island use tax. That is because JKL is eligible for a credit for sales tax paid to another jurisdiction. In this example, JKL applies the Massachusetts sales tax rate of 6.25 percent against the Rhode Island use tax rate of 7 percent. The difference is 0.75 percent. (Please see table below.)

Table for Example # 5	
Rhode Island use tax @ 7%	\$ 1,190.00
(Massachusetts sales tax paid @ 6.25%)	( \$ 1,062.50 )
Net Rhode Island use tax due	= \$ 127.50
Example shows gross Rhode Island use tax owed on \$17,000 purchase, less credit for sales tax paid to Massachusetts on that purchase, equals net Rhode Island use tax due.	

### Example # 6

MNO Salon paid \$4,500 for chairs for the salon's waiting room. MNO bought the chairs from a store in Connecticut, which charged Connecticut's 6.35% percent sales tax. MNO paid no Rhode Island sales tax on the furniture. In that case, MNO owes \$29.25 in Rhode Island use tax. That is because MNO is eligible for a credit for sales tax paid to another jurisdiction. In this example, MNO applies the Connecticut sales tax rate of 6.35 percent against the Rhode Island use tax rate of 7 percent. The difference is 0.65 percent. (Please see table below.)

Table for Example # 6	
Rhode Island use tax @ 7%	\$ 315.00
(Connecticut sales tax paid @ 6.35%)	( \$ 285.75 )
Net Rhode Island use tax due	= \$ 29.25
Example shows gross Rhode Island use tax owed on \$4,500 purchase, less credit for sales tax paid to Connecticut on that purchase, equals net Rhode Island use tax due.	

## APPLICATION PROCESS

**Q: Is there an application form available?**

A: The application form, and other information, is available on the Tax Division's website under the "self-audit" section: <http://go.usa.gov/3JexQ>

**Q: How will the program work, step-by-step?**

A: Following is a summary of the process:

APPLY: You must file a formal application with the Tax Division. Once you apply, the Tax Division will respond, in writing, within 30 days to let you know whether your application has been approved or denied.

APPROVAL: If your application for the program is approved, the Tax Division will assign your case to a revenue agent from the agency's Field Audit section. The letter that the revenue agent mails to you, confirming that your application has been approved, will also include lists of documents you will be required to gather and submit, and other information. The Tax Division will also assign you an "audit period" - in other words, the period of time that the audit should cover; it's the period on which you will focus to see if you have any delinquent use tax. (It's typically the last three years, or the period from when your business's operations began, whichever is shorter.)<sup>8</sup>

AUDIT: The Tax Division's letter will confirm the time frame within which you must complete the self-audit (typically 60, 90, or 120 days, depending on various factors, such as the number of records that will have to be examined as part of the self-audit).

RESULTS: Submit your completed audit on time, with payment of the tax due and with the required documentation. Once the Tax Division receives your submission, the agency will have 30 days to confirm your results. During that time, the agency will, among other things, review your submission for accuracy, check it for math errors, and determine if the required documents are included. The agency may also review your depreciation schedules, general ledger, and purchase invoices, among other things; request additional information; or perform an on-site inspection.

IMPACT: If your-self audit results are accepted, penalties will be waived. You'll be billed for interest, but at a reduced rate. In addition, the Tax Division will not audit you for the tax type and time period covered in your self-audit.

**Example # 7**

Dorr, Burnside, Lippitt & Sprague, LLP, a well-established Providence law firm, each year buys software, which the firm uses to create legal documents and bill clients. The software is widely available in the industry and costs \$5,000 a year. The firm buys the software online from a remote seller; no sales tax is charged. During its self-audit, the firm discovers that it has never paid Rhode Island's 7 percent use tax on those purchases. It pays the tax due to the Division of Taxation: \$350 a year for 2013, 2014, and 2015, for a total of \$1,050 in tax. The results of its self-audit are filed in a timely and accurate manner. The Division of Taxation approves the result, waives penalties, and bills the firm at a rate of 6 percent interest per year,

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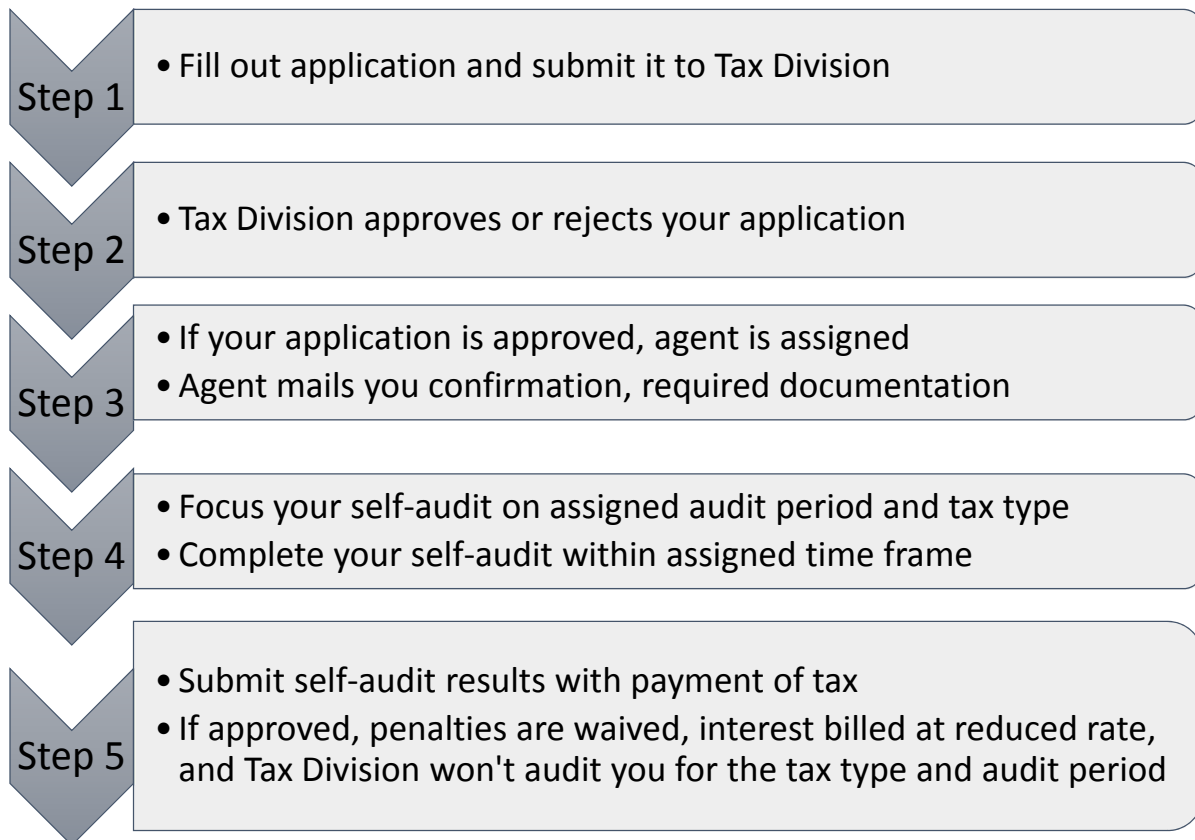
<sup>8</sup> If you are a non-filer, the audit period is typically six years.

instead of at a rate of 18 percent per year that would otherwise be due. (The firm pays one-half of 1 percent per month for each month that the tax was not paid.) The Division of Taxation agrees not to audit the firm for use tax for 2013, 2014, and 2015.

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*Following is an at-a-glance guide to the steps involved in the self-audit process as managed and overseen by the Tax Division.*

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### OTHER MATTERS

**Q: If I am accepted into the program, what if I have more questions?**

A: You may call or email your revenue agent at any time during the process if you have questions or need guidance. The Tax Division reserves the right to request additional documentation regarding the self-audit. The agency also reserves the right to conduct a physical inspection of your place of business to verify the accuracy of the audit.

**Q: How often can I take part in the program?**

A: Only once per three-year period. One of the goals of the self-audit program is to encourage ongoing compliance with use tax requirements by participants after the initial self-audit. In other words, once you complete the self-audit, you will be expected to file any future use tax liability on a timely basis, using Form T-205: <http://www.tax.ri.gov/forms/1999/excise/t205.pdf>.

You still may submit a program application to the Tax Division for another three-year period and the Tax Division will review the application. If there are circumstances that demonstrate that you may be eligible for another self-audit, the Division will review your application, taking into account that you may have already received the benefits of penalty and interest forgiveness in a prior self-audit.

**Example # 8**

Oakland, Mapleville, and Bridgeton, an accounting firm in Burrillville, takes part in the Tax Division's self-audit program for the three-year audit period covering 2012, 2013, and 2014. The firm could apply under the program again at some point, but if such future application were approved, the audit period could not include 2012, 2013, or 2014. Also, if the firm incurs use tax liabilities after its first self-audit under the program (the one covering 2012, 2013, and 2014 in this example), the firm should submit those taxes on Form T-205: <http://www.tax.ri.gov/forms/1999/excise/t205.pdf>

**Q: Please elaborate on how much interest the Tax Division will forgive.**

A: If you complete the self-audit in the allotted time, the results are accurate, and no additional information or documentation is required, the Tax Division will forgive two-thirds of the interest. Thus, instead of billing you for 18 percent interest per year, the agency will bill you for 6 percent interest a year.<sup>9</sup> However, if you fail to complete the self-audit in the allotted time, or if the initial results are inaccurate, or if the Tax Division requires additional information or documentation, the agency may bill you for 12 percent interest per year rather than the usual 18 percent.

**Q: Are there any other factors the Tax Division will take into account in determining whether I can take part in the program?**

A: The agency will take a number of items into account in determining whether you can participate in the program. For instance:

- Do you consistently file tax returns on time with the State of Rhode Island – returns that are accurate and that reflect full payment in accordance with Rhode Island law?
- What tax types and tax returns do you file with Rhode Island on a monthly, bi-monthly, quarter-monthly, quarterly or annual basis?
- Do you have the time, resources, and personnel to complete a self-audit managed by the Tax Division within a certain amount of time?
- Are the documents related to the self-audit readily available and accessible for all of the audit periods? (Such documents may include depreciation schedules, federal and state

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<sup>9</sup> Under RIGL § 44-1-7, the interest rate on delinquent tax payments has been set at 18 percent per year since 2006.



returns, purchase journals with invoices, a chart of accounts, and other pertinent paperwork.)

- Has your business – or any related company – filed for protection from creditors under federal bankruptcy law or state receivership law within the last 10 years?
- Have you ever received a declaratory ruling or any type of written ruling from the Division of Taxation or its representatives?
- Has the Division of Taxation performed any type of audit of your business – or of any related entity – in the last five years?
- Are you prepared and able to make full payment of tax due, and of any interest assessed, at the time of completion?

Keep in mind that the program is aimed chiefly at two types of cases:

- non-filers, and
- filers that are unaware (prior to the self-audit) that they have a tax liability.

**Q: Have any other states offered a similar program?**

A: Vermont and Pennsylvania are among the states that have offered similar programs. Various states use different terms to describe their programs. Vermont has used the term “self-audit” to describe its program; we are using that term, too.

**Q: Do I have to be invited by the Division of Taxation to participate in the program?**

A: No. Nearly everybody is eligible to participate. The program application contains more details. (Please note, however, that the program at this time is limited only to use tax, and is not open to retailers.) The Division of Taxation recently began a mailing to about 9,600 businesses and individuals to provide them with information about the program. The mailing includes a letter, a flier, and an application. But the mailing is intended mainly to kick things off; you need not be on the mailing list to participate in the program.

**Q: Suppose I’m eligible for the program but decide not to participate?**

A: If you choose not to participate in the self-audit program, you may be subject at some point to a full audit by a revenue agent of the Division of Taxation’s Field Audit section. Such an audit will be for a period of at least six years; it will not be limited to the three-year period available under the self-audit program. If the Division of Taxation audit unearths use tax liability, you will owe not just the tax, but also a 10 percent penalty as well as 18 percent per year in interest.

**Q: Where can I get more information about the program, including an application?**

A: The “self-audit” section of the Tax Division’s website contains more information, including the program’s application and other documents: <http://go.usa.gov/3JexQ>

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This document contains an informal, plain-language summary of certain provisions of recently enacted legislation, H 5900Aaa. These FAQs are not a substitute for Rhode Island General Laws or for Rhode Island Division of Taxation regulations or rulings. Nothing contained in these FAQs in any way alters or otherwise changes any provisions of Rhode Island statutes, regulations, or formal rulings.

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