



# SALES VS USE TAX

*Retailers who sell online and ship jewelry can find that navigating sales and use tax can prove to be rather tricky.*

BY SHUAN SIM

**AS MORE JEWELERS SELL ONLINE** and ship across state lines, determining whether or not to charge sales or use tax has become complicated. This is largely due to the lack of a cohesive sales tax rule federally, or even between states. Jewelry products can be pricey and discrepancies in tax rates can mean a substantial difference in the final price tag, affecting the customer's purchase decision.

To woo customers, some retailers offer to ship their purchase out-of-state to avoid having to charge sales tax. However, in some cases, they may not realize that they might have to collect use tax, which is a tax on remote sales applicable when sales tax was not collected, on behalf of the customer. In situations where sales or use tax was not collected by the seller, the use tax reporting burden is pushed onto the customer

(see "What is Sales/Use Tax?" on page 85). Depending on circumstances, failure to comply with appropriate tax requirements could result in penalties for retailers and sometimes, even the customer.

## **DETERMINING SALES/USE TAX**

Any tax to be collected, be it sales or use, is determined at the point of delivery, or where title changes hands to the customer, explains Robert Hoberman, managing partner at New York City accounting and advisory firm Hoberman & Lesser, LLP. When a customer walks into a retail store, makes a purchase and physically obtains the jewelry in-store, that is where the point of delivery is and local sales tax rules, if applicable, occur.

However, the same customer could have the retailer ship the jewelry to an out-of-state location, which

## WHAT IS SALES/USE TAX?

Sales tax is a tax on all retail sales of tangible property and/or services made within a state. Use tax applies to consumers on purchases made out of state that did not have sales tax collected. Use tax can either be collected and reported by the seller on the consumer's behalf or self-reported by the consumer.

Sales and use tax are mutually exclusive and both cannot be collected on the same sale.

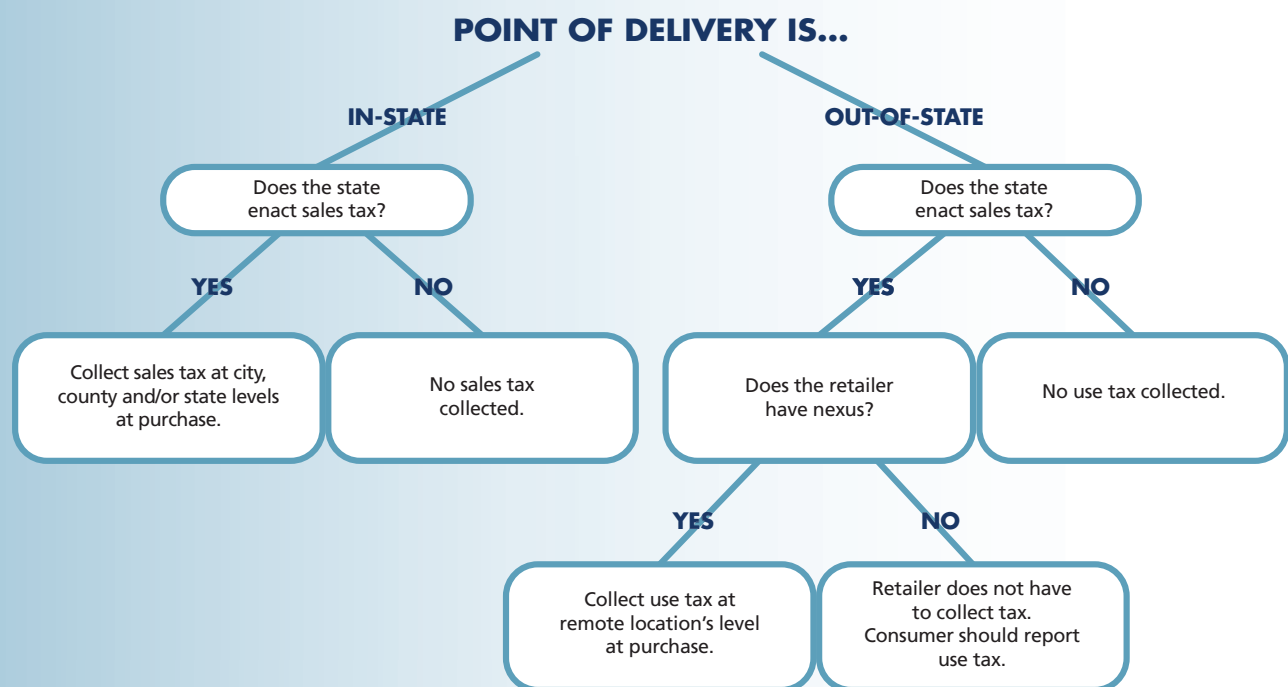
"The reason why there is a distinction between sales and use tax is because of a federal rule that prohibits states from interfering with other states' tax laws and charging sales tax in another state," says Marc Brandeis, founder of Brandeis & Associates, LLC, a sales and use tax consultancy in Orange County, California. "However, states have the power to charge use tax for goods brought in for consumption within their own state." He adds that sellers who collect use tax on the behalf of consumers sometimes label it as "sales tax" on the invoice. "They do it so as not to confuse the customer, or because they don't understand the difference between the two terms themselves, but in actual fact they are charging use tax," Brandeis explains.

Currently, 45 states and Washington D.C. impose sales and use tax. Alaska, Delaware, Montana, New Hampshire and Oregon do not have general sales taxes.

then becomes the point of delivery. If that state has sales/use tax, and the business has what is considered to be a nexus, or substantial physical presence (see "Nexus" on page 86), the seller has to collect use tax on the purchase on the behalf of the customer. The use tax, charged at point of sale, is then remitted to the state of the point of delivery. This also applies to online purchases.

If the jewelry is shipped out of state and the retailer has no nexus in the point of delivery state, the seller collects no sales or use tax. The consumer would

then have to voluntarily report the use tax on his or her income tax return. "There is no requirement in most states for retailers to inform consumers about consumer's use tax," says Jennifer Dunn, chief of content at TaxJar, a sales tax compliance software company. Some states, including Alabama, Colorado, Louisiana and Vermont, have a remote seller's law — sometimes known as a "tattletale law" — that requires companies to either provide the government information on uncollected sales and use tax or email consumers information for use in consumer's use tax



## NEXUS

*An out-of-state business with nexus, also known as “sufficient physical presence,” is liable for collecting seller’s use tax on purchases. Having a brick-and-mortar store is an example of having nexus in the state, but other less obvious examples could include simply having an employee or affiliate in the state, says Dunn. “If you have an employee physically delivering a piece of jewelry to a customer, that could count as nexus,” Hoberman says. For that reason, common carriers delivering purchases do not count as nexus since they are not employees of the retailer.*

reporting. Some states, including Kansas, have similar legislative proposals.

### BIG TICKETS, BIG ATTENTION?

Sales or use tax on big-ticket items—jewelry for example—not being collected and reported can be a substantial loss of revenue for the state. “If you’re selling or buying things at a flea market, it’s likely the state will not come after you for not collecting or reporting sales or use tax,” says Dunn. “Who they’re after are the big-money tax evaders, so high-dollar retailers could be audited,” she elaborates. While cases of states going after individual consumers for failing to report consumer’s use tax are rare, high-profile cases have been investigated—such as that of L. Dennis Kozlowski, former CEO of security systems company Tyco International. He served a sentence of over six years behind bars and paid over \$3 million in back sales tax for purchases of jewelry and art.

## TAX PENALTIES

Jewelry purchases that are shipped out of state, where the retailer has no nexus at the point of delivery relieves the retailer of any sales or use tax liability. “If retailers can prove it is shipped out of state by common carrier, the burden of proof shifts to the consumer,” says Hoberman. These could include a receipt from a common carrier, shipping insurance, an invoice that indicates destination or a response or receipt by the customer.

Should there be nexus, a state’s tax authority’s aggressiveness in cracking down on compliance failure could depend on the size of the company or perception of tax amount owed, says Dunn. She highlights three broad categories in which collecting and reporting sales and use tax could go awry.

- Did not register to collect tax and did not collect tax: “The retailer may or may not be caught,” says Dunn. “States can be quite behind the technological curve when it comes to being up-to-date with online sellers,” she says, adding that some states are better than others at monitoring taxes owed from online sales.
- Registered to collect tax, but did not, or under-collected tax: “If you’re compliant, the state usually won’t bother you,” Dunn notes. She points out that this is where company size might matter and if a retailer is generally compliant with tax laws, an occasional slip up might result in a fine and interest on amount owed.
- Not registered to collect tax, but collected tax: “We’re talking about tax fraud here,” explains Dunn. “In this situation, you’d have represented yourself to the customer that you are collecting sales tax and are pocketing it, and this could result in a jail term,” she says. Even accidentally charging sales or use tax where one is not supposed to is not defensible, Dunn adds.

## EXEMPTIONS AND COMPLICATIONS

Even if sales tax were collected, it has to be reported accurately. “There can be various ways you can be penalized if you do not report sales tax properly,” says Hoberman. “There could be penalties for late filing and late payment, interest on balances due, and/or professional fees to protect yourself in the event of a sales tax examination,” he explains.

Various situations, including trade and trunk shows, festivals and sales to diplomats, hold special rules or exemptions for sales and use tax too, according to Hoberman and Dunn. “Interpreting whether and how the rules apply to a specific situation, especially one that you are encountering for the first time, can be difficult. In those circumstances, your best option is to seek qualified tax guidance from an advisor,” Hoberman concludes. ♦