

What lawyers need to know about sales and use tax

By Robert W. Wood

Sales and use tax were confusing enough even in the old days. Now that we all buy online, the confusion is more palpable and emotions about whether we pay are running high. The impact on businesses, as well as consumers, is vast.

Who needs a sales tax permit and what's your liability if you don't have one? What's a sale and what's a service, and are services ever subject to sales tax? Why do some food and beverage items trigger a sales tax while others do not? And how on earth do you know if you'll pay tax on Internet purchases?

If you are a lawyer in private practice, you are performing services, not selling products. That means you should not need a permit from the California State Board of Equalization (SBE). A seller's permit means you can make retail sales and collect sales tax.

Use tax has always applied to purchases of new tangible property you buy on Amazon. It was only the *collection mechanism* for the tax that has long been controversial.

Sales tax is almost always paid by the buyer. Yet it is the seller who is obliged to collect and remit it. If the seller isn't required to collect and remit it, use tax would still apply but that is up to the buyer to handle. But since sellers are easier to track down, if the seller fails to collect or remit the tax, the seller is liable. In many cases the liability goes beyond the business entity and is personal.

What's more, if the SBE audits you and finds that you have no permit and haven't filed returns, the statute of limitations is a long eight years. If you have a permit and file returns, the statute of limitations is reduced to three years. Just three years of back sales tax, interest and penalties can be devastating, while eight years' worth can be catastrophic.

Many businesses involve both sales and service, and invoices are split between the two. When your car is repaired, you pay sales tax on the new parts but not on the labor and installation costs. Services are traditionally exempt from sales tax, and although some states have experimented with a tax on services (a tax on fees paid to lawyers was tested in Florida), we are safe so far.

Some states tax food, but California exempts groceries. However, much of the line-drawing may seem silly. Food served at a restaurant is taxable while in a grocery store it generally is not. But some take-out food blurs the line and is taxed. That's also why you may be asked: "Are you going to eat that here?"

The Internet adds a new breed of confusion. Whether by phone, catalog or online, purchases from sellers out of state shouldn't trigger California sales tax. But such purchases do trigger use tax, which is the mirror image of the sales tax.

If you buy a new computer in a store in California you pay sales tax. If you buy it from a non-California vendor online, you should pay use tax. But the more immediate question is whether the seller will collect the California use tax when you check out at the point of sale.

Welcome to California's Amazon Tax. Use tax has always applied to purchases of new tangible property you buy on Amazon. It

was only the *collection mechanism* for the tax that has long been controversial. The question today is whether you will pay tax to the vendor (who in turn will remit it to California), or if you must report on yourself and pay the use tax. If you bought at Macys.com, Macy's will collect the tax because there's a Macy's brick and mortar store in California. Even if the site where you buy doesn't have a store in your state, a warehouse or distribution facility may be enough to qualify as a tax nexus with California.

Under California's version of the Amazon tax, of course, Amazon now collects the tax. Amazon has sufficient connections with California, so even though it has no brick and mortar store here, it's collecting. Many other vendors — based on the size of their California sales (generally over a \$1 million) or based on agreements signed with California — are collecting tax too.

Isn't this unconstitutional? It doesn't appear to be, although that may depend who you ask. In 1992, the U.S. Supreme Court ruled in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), that no state can constitutionally force an out-of-state merchant to collect sales or use tax unless it has a nexus — physical presence — in the state. But the court actually invited Congress to pass a national law. The constitutional prohibition is only on the states.

In 1992, the concern was catalog and telephone sales creeping from one state into another. The Internet is far more powerful and more invasive. The sales tax revenue losses are huge and something has to give.

In all, 45 states and the District of Columbia have sales taxes, so it's not just California. And every state that has a sales tax also has a use tax. And while you may have scoffed at use tax compliance in the past, you should do so no longer. Enforcement was historically weak, but there are big changes afoot.

If you are ordering goods online and have them shipped into California, you should pay your use tax. You must report use tax due on purchases you make from out-of-state (including on the Internet). If you have a California business, use tax is reported on your income tax return.

What's more, the use tax issue will often come up in the course of an income tax audit. If you thought consumers were safe from these rules, that's also no longer true. Even individual income tax returns today ask for use tax.

What will the future hold? California's sales and use tax grasp is likely to grow stronger still. With several federal tax bills to regulate online sales tax pending, stay tuned.

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