

IDEAS



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ASK ALAN | BY ALAN FRIEDMAN

SALES TAX DEMYSTIFIED

In the 12 years I've written for *Music Inc.*, there's one important topic I've missed: sales tax. Maybe I did this on purpose. One could write a book on sales tax, and it would only scratch the surface — not to mention everything would've changed by the time it came out. Maybe I skipped sales tax because it's boring and would put readers to sleep. But boring or not, it's important, relevant, ever-changing and often misunderstood. And it can cause a world of hurt if misapplied.

Since a discussion of sales tax could cure anyone's insomnia, let's dedicate a whopping 10 minutes to the topic and look at why it needs to be addressed by all music retailers.

SALES TAX DEFINED

Basically, a sales tax is a consumption tax — meaning it's a tax levied on a consumer's spending on goods and services — and it's assessed at the point of purchase. It's usually set as a percentage by the state, county and/or municipal government and gets calculated by applying that set percentage against the price charged for taxable goods and services. Often, various goods and services aren't subject to sales tax, but these vary



from state to state. While clothing may be exempt from sales tax in New Jersey, it may be subject to sales tax in neighboring New York or taxable over certain dollar amounts.

Most sales taxes are collected from the customer by the product seller or service provider and remitted to the state or local government. Generally, the sales tax's economic burden falls on the end-user of the product or service. For most products sold in the music industry, the end-user is the retail customer.

Some younger or newer music store owners may be thinking, "Cool, I've got it — charge my customers the applicable tax on whatever they buy,

send it to the government and I'm done." But we older, battle-weary retailers, bookkeepers and accountants who've been through sales tax audits know compliance with sales tax laws is nowhere near that simple.

WHERE THE FUN BEGINS

Let's look at the complexities of sales tax collection in our industry. The first sale of any musical instrument or product really isn't a sale to the retail customer. It's actually a sale from the supplier to the retailer or from the supplier to a distributor that sells it to the retailer, which then sells it to the end-user. Sometimes, the end-user isn't even the music store's customer, as it could be a contractor buying a sound system to sell to and install in a nightclub.

So, if the product's end-user is responsible for paying the sales tax, how do all the companies not selling to an end-user avoid the responsibility of collecting and remitting sales tax? They must obtain (and produce under audit) a resale certificate from their customer. Otherwise, these companies have to charge and remit sales tax on each taxable item they sell to a customer who can't produce such a certificate,

whether that customer is the end-user or not. Or worse, the sales tax plus interest and penalties may get levied against these companies during a sales tax audit. Lovely.

WHAT'S THIS 'USE TAX'?

There are actually several types of sales taxes. Some governments charge a gross receipts tax on all sales, which taxes an item more than once as it makes its way from production to final retail sale. There are also consumer excise taxes on such items as gasoline and alcohol, often imposed on the producer rather than the seller. And there are value-added taxes, where tax is charged on all sales to avoid the need for resale certificates.

But a popular, yet often ignored, sales tax is the use tax. It's imposed directly on the end-user who hasn't paid his or her rightful share of sales tax at the point of sale. How does an end-user avoid paying this tax at the point of sale? Make the purchase in another state or over the Internet.

While use taxes are imposed by most states, they're difficult to enforce and result in billions lost to state and local governments. Here's where this topic

gets downright ugly, and I'm going to make it even uglier.

SALES TAX ON THE INTERNET

There has been a growing, heated discussion about the uneven playing field between brick-and-mortar retailers required to collect sales tax and e-retailers that aren't. In 1992, the Supreme Court ruled in *Quill Corp. vs. North Dakota* that a state government can't make companies without a physical presence in a state collect that state's sales tax. That means Amazon.com may only be required to collect sales tax in such states as Washington, where it has an office and warehouse. It's up to Amazon.com's customers to pay their rightful share of use tax.

Many state governments are trying to change sales and use tax laws, given the billions lost from an inability to enforce use tax compliance. You can monitor their efforts at the Streamlined Sales Tax Project (SSTP) Web site, streamlinedsalestax.org. It aims to assist states in administering a simpler, more uniform sales and use tax system.

And while online retailers have been fighting proposed tax law changes for years, no one appears to be more vocal than eBay. Brian Bieron, the company's senior director of federal government relations and global public policy, made the following comments on Internet-related sales taxes:

"To be clear, the Streamlined Sales Tax governing board does not propose establishing a uniform sales tax rate among the states, nor does it even require a single sales tax rate within each state. Instead, the Internet sales tax regime envisioned by the SSTP would be a very complex set of rules and rates, with many thousands of state and local tax

jurisdictions across the country. Requiring small business retailers to collect and remit taxes based on thousands of different jurisdictions, keep the detailed records for every different transaction and tax jurisdiction for years, and be subject to audits by each state is a long-term negative for small business retailers trying to use the Internet. If the states were to ever come to Congress with a proposal where 'all states were to agree on a uniform tax rate,' eBay and eBay sellers would carefully review that proposal. But make no mistake: That is nothing like the complex and ever-changing Internet sales tax proposal being promoted by some states and giant retailers."

CAN YOU SEE THE STEAM RISING FROM MY HEAD?

Mr. Bieron's remarks anger me. Am I the only person who thinks he's pretending to protect the interests of small retailers and really trying to avoid burdening eBay's business model with sales tax collection?

I'd figured Mr. Bieron and eBay would've stated their support for a simple system that closes the unfair and ultimately damaging Internet sales tax loophole, instead of reviewing a proposal on a uniform tax rate. Yes, I am vehemently in favor of imposing a simple, uniform sales tax collection policy on *all* retailers, whether they sell via the Internet, catalogs, brick-and-mortar stores or out-of-store events.

A short story. Last year, immediately after a NAMM University session on the status of Internet sales tax collection, two retailers approached me. One, an online retailer, began complaining about my "narrow-minded" support of an "Internet tax" and how it would hurt his

'Shame on you narrow-minded online retailers for not seeing past your self-serving interests.'

business. The other retailer, a brick-and-mortar, came to my rescue, asking the online retailer if he sold products to students and young, aspiring musicians. The online retailer admitted they made up a big part of his clientele. The brick-and-mortar retailer replied, "How would your business be doing if states, towns and schools that teach and support your musician customers no longer had the revenue to promote music programs and musicianship?" Dead silence. Point made.

In short, shame on you, Mr. Bieron, and other narrow-minded online retailers for not seeing past your self-serving interests and considering the long-term effects of these unfair tax-collection loopholes.

THE FRIEDMAN PROPOSAL

Why don't we simply let all retailers collect sales tax on *all* transactions at their state's prevailing rate and remit it to their state governments? It would level the playing field and pump billions in revenue back into our state and local governments and, hopefully, our school music programs. We'd probably save on state and town law enforcement services by keeping kids off the streets and in meaningful, mind- and spirit-expanding activities. Let the states figure out how to divvy it up. For heaven's sake,

no matter who gets what, these state governments will be billions ahead, fiscally speaking.

I believe all Internet sales will eventually be taxed the same way as sales at brick-and-mortar stores, but that day can't come fast enough. I repeat: This isn't about a *new* Internet tax. This is about fixing our inability to track and collect taxes from end-users on Internet transactions.

DON'T WORRY, BE HAPPY

I'll end on a somewhat positive note by offering a couple things you can do to structure your business transactions to reduce future sales tax burdens. If your store operates in multiple jurisdictions, the way you deliver product or structure invoices can affect an entire transaction's taxability. Check your operating expenses to determine which assets and services may qualify for overlooked exemptions. (These are often listed on a state's sales tax Web site.) A periodic review of procedures, relating to the gathering of sales and use tax data and the retention of exemption and resale certificates, will go a long way to protect you in the event of a sales and use tax audit.

Lastly, contact your attorney to make sure your instrument rental contracts are in compliance with state and local sales tax laws. If ever you find yourself in hot water with a sales tax auditor, seek a sales tax professional's advice. We've found sales and use tax audits to be much more intrusive, time consuming, complicated and costly than income tax audits.

OK, you can go to sleep now. **MI**

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