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## Sales-Tax Traps Snare Unsuspecting Companies

By **Martin C. Daks**

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As budget-strapped politicians look for new sources of tax revenue, businesses across New Jersey and elsewhere can expect to face stepped up sales- and use-tax audits, say some CPAs.

“There’s a great deal of confusion when it comes to sales and use taxes and the Internet transactions,” says **Marguerite L. Mount**, a principal at the Princeton CPA firm of **Mercadien P.C.**

“It’s not unusual for out-of-state sellers to neglect to charge sales tax on purchases made over the Internet, and for buyers to then neglect to pay use tax” for the same amount, to be remitted if sales tax is not charged on a taxable transaction, Mount says. “New Jersey routinely performs comprehensive audits that target sales and use, and other activities.”

Business-to-business e-commerce generates more than \$2.7 trillion a year in activity, according to U.S. Census Bureau estimates, making Internet sales a tempting target for tax collectors.

In fact, CPAs say some sellers may not know when they are responsible for collecting sales tax on Internet transactions, and buyers may not know when they have to turn in use tax.

A 1992 U.S. Supreme Court decision, **Quill Corp. v. North Dakota**, “set down the standard that a seller company does not need to collect and remit sales tax unless it has nexus, or substantial physical presence in the state where the sale takes place,” Mount says.

But if a seller is not obligated to collect sales tax, the buyer generally has to remit an equivalent amount, known as the use tax, to state authorities.

Determining nexus — and the seller’s obligation to collect sales tax — is relatively simple when a customer walks into a store and makes a purchase, since both parties are in one spot. But the issue gets cloudy when it comes to Web-based transactions.

“Let’s say a customer in one state buys and downloads software over the Internet from a New Jersey-based company,” says **Mike Hoffman**, senior tax manger at the Princeton office of the accounting firm **Withum, Smith & Brown**. “Where did the sale take place? If it went through a server in the customer’s state, does that give the seller physical presence there?”

Complying with the maze of sales tax regulations can be a nightmare, especially for smaller companies that cannot afford to keep sales-tax experts on staff.

For starters, the very definition of nexus may vary from one state to another. Then, products and services that are subject to sales tax in one state may be exempt in another state. Finally, sales-tax rates vary by state, and within a particular state, some local and county governments may impose their own sales tax on top of the state tax.

It is not unusual for smaller companies, and some large ones, to neglect to bill sales tax on Web sales or to pay use tax on Web-based purchases, says **Pamela Avraham**, a partner with the Highland Park CPA firm of **Urbach & Avraham**. Of course, that does not sit well with cash-strapped state authorities.

“Over the past two or three years we’ve seen a significant jump in state audits, even at small mom-and-pop shops,” Avraham says. “One of my clients, a temporary services firm, was audited, and had to pay use tax for employee drug-test kits and specialty gloves that it had bought online without getting billed sales tax.”

It can be a costly mistake, she adds.

“The state may audit a selected period, and then apply the results over multiple years that are being questioned,”

Avraham says.

"In addition to the uncollected sales tax, the business may be liable for late penalties and interest charges," she adds.

Even as states step up their sales- and use-tax scrutiny, some are also pushing the boundary when it comes to determining if a company has to collect and remit sales tax, says Alex Serrano, a CPA who is partner-in-charge of the Springfield office of Citrin Cooperman & Co. LLP.

Earlier this year, New York state passed a law requiring online retailers, like Amazon.com, to collect tax from New York customers even though the online retailer has no facilities in the state. The theory is that so-called affiliates, or independent companies that maintain a Web presence and earn referral fees for sending customers to the online retailer, establishes nexus in New York.

In April, Amazon filed suit against New York in the state Supreme Court challenging the law.

So far, New Jersey has not been quite as aggressive, but in 2006, the state did extend the sales tax to certain services, such as landscaping and most membership fees that were previously tax exempt, Hoffman says.

"A lot of companies are making mistakes because they are not aware of the [many] rules concerning sales and use taxes," he says. "But all it takes is one sales-tax audit to become educated."

E-mail to [mdaks@njbiz.com](mailto:mdaks@njbiz.com)

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Mike Hoffman, senior tax manager at Withum, Smith & Brown, says Web-based transactions can make sales-tax regulations difficult to determine, because it's hard to pinpoint the state in which the sale was made. [Steven J. Dundas]