

ASK ALAN | BY ALAN FRIEDMAN

Alleviating Sales Tax Anxiety, Part 1

Will the fervor topic of sales tax on internet and out-of-state sales ever end? While the now red-hot topic of sales tax collection will eventually cool down, it'll only happen once music retailers understand and accept their newfound responsibilities. Until then, stress and anxiety will undoubtedly continue to permeate through any conversation about sales tax compliance.

As if music retailing wasn't challenging enough, most store owners are now frantically trying to get their heads wrapped around new and ever-evolving sales tax laws stemming from the 2018 Supreme Court decision regarding a state's right to collect sales tax from out-of-state retailers. In response to the endless stream of questions, confusion, misconceptions and fear of a sales tax audit, this first of two articles (coupled with the upcoming Winter NAMM special session at the Anaheim Hilton, Friday, Jan. 25 at 10 a.m.) will be my attempt to alleviate some of the mystery and resulting anxiety over sales tax compliance.



Understanding and accepting newfound responsibilities is a necessity for retailers

WHAT HAPPENED?

If you happened to be on vacation or getting ready for rental season or on tour with your band of aging rockers over the summer of 2018, you may have missed a monumentally important ruling that affects every retailer in the U.S. If so, here's what you missed. On June 21, 2018, the U.S. Supreme Court finally weighed in and changed their position on a 26-year-old ruling, previously referred to as the Quill Decision. The new ruling (arising from the South Dakota vs. Wayfair case, now called "The Wayfair Act"), gives every state the right to force all retailers to collect sales tax on taxable sales into their state.

Make no mistake, this will bring huge new revenue to most states that were previously unable to enforce and/or collect sales tax on sales into their state from online and other out-of-state merchants. Until now, sales tax collection was governed under an old rule, known as the "physical presence test" that dates back to "The Bellas Hess Case" of 1967. In that case, the Supreme Court held that the State of Illinois could not require an out-of-state catalog company to collect sales tax on an Illinois customer unless the company had a physical presence in Illinois, also referred to as "nexus," which is the requirement to collect sales tax. The premise was sales tax compliance is so complex to properly assess and collect that forcing out-of-state sellers to do so puts an impermissible

burden on interstate commerce. That ruling was reaffirmed by the Court in the 1992 Quill case, although there were some misgivings over whether it was the correct ruling.

WHAT CHANGED?

Over the years that followed, several factors began to undermine the physical presence test. The internet emerged and e-commerce grew rapidly, resulting in many online sellers not collecting sales tax on millions (or even billions) of online sales dollars. Even though sales tax (aka "use tax") was still required to be paid by the customer to their home state, few did and states had no way of knowing about or enforcing that sales/use tax liability. Retailers who did comply with the varying state sales tax collection laws began to make investments in e-commerce web technology which eased the burden of collecting sales taxes and spawned affordable software solutions for many retailers.

Finally, the physical presence rule proved to be an ineffective measurement of a state's right to assess tax. The new question became whether a state's sales tax laws discriminate against interstate commerce. If complying with a state's tax system is so burdensome on an interstate seller that it hinders sales, it is deemed unconstitutional regardless of the level of the seller's physical presence in that state. These, and other factors, became the basis for the 2018 Wayfair decision.

WHAT HAPPENS NOW?

The State of South Dakota now has the legal right to require an out-of-state retailer (like one headquartered in Connecticut, for example) to collect sales tax stemming from online sales of product to a South Dakota resident. Under the old law, that Connecticut retailer had to have a brick-and-mortar store or inventory (physical presence) in South Dakota to be required to collect South Dakota sales tax from that South Dakota customer.

It's important to note there are state-by-state dollar amount and/or number of transactions thresholds that need to be exceeded before a state can require the collection of its sales tax by an out-of-state retailer. But generally speaking, any retailer selling more than \$100,000 into another state is best advised to check with that state's tax authority as they may find themselves required to collect that state's sales tax.

WHEN WILL THIS ALL TAKE EFFECT?

Some states have already started to enact sales and use tax laws similar to South Dakota's efforts to collect on internet purchases. Other states will need to make significant infrastructure changes to their collection system to be able to begin collecting any new sales tax. A few other states that currently have no sales tax, such as New Hampshire, will likely never pass a sales tax.

Another question is whether Congress will get involved and enact new related laws, some of which are already pending. Any law Congress passes would surely go hand-in-hand with the Supreme Court's ruling by providing more protections for sellers and consumers. But there's been opposition to the passage of these pending bills, so we'll have to simply wait to see what happens next.

HOW WILL THIS IMPACT E-COMMERCE?

As brick-and-mortar retailers have hoped since the birth of e-commerce, this ruling has finally leveled the proverbial playing field of retailing.

Online retailers will now have to collect the same sales tax collected by all other retailers. If you believe the hype that the advantage online retailers have over brick-and-mortar stores is convenience, wider selection and lower costs, then it's unlikely this decision will hurt larger online retailers.

But a valid concern is whether the smaller online retailer has the ability to comply with the burden of collecting interstate sales tax. As previously mentioned, Congress is considering a bill that would provide additional protections for retailers, such as limiting

interstate audits, requiring states to pay for integrating sales tax collection software into a seller's accounting system, and setting reasonable sales thresholds exempting smaller businesses from having to comply with too many sales tax rules. But for now, we will again have to wait and see what new sales tax laws ultimately get passed. More anxiety.

WHAT DO I DO NEXT?

Some of you, especially retailers with numerous online sales, are now in a cold sweat trying to absorb all of these changes

with the added administrative burden to comply with each state's sales tax laws. To help your music store achieve sales tax compliance, Part 2 will provide a roadmap of useful tips to help you stay on top of the ever-changing sales tax landscape.

Stay tuned, and make sure you add the Friday morning session to your 2019 Winter NAMM schedule. Happy new year! **MI**

Alan Friedman, CPA, provides accounting and financial services to music industry clients. He is a frequent speaker at NAMM U seminars and can be reached at 860-677-9191 or alan@fkco.com. Visit his website, fkco.com.

RBImusic

musical instrument distributors since 1961

Going to NAMM? Come See Everything New at RBI! Visit us at Booth #6404



800-424-4724 • RBImusic.com • sales@rbimusic.com