REGULATORY & TAX

Sales & Use Tax: Definitions May Vary By Jurisdiction

By Diane L. Yetter

Since each state—and in some cases, locality—administers its own tax, definitions may differ by jurisdiction. It is imperative to review the particular jurisdiction's definitions and exemptions as they relate to your business. An incorrect interpretation may result in liability to your business.

Sales Tax is defined as a tax on the sale, transfer, or exchange of a taxable item or service. The Sales Tax generally applies on the sale to the end user or ultimate consumer. The Sales Tax is generally added to the sales price and is charged to the purchaser. Sales Tax in its truest definition applies only to intrastate sales where the seller and the customer are located in the same state. Sales Taxes are considered "trust taxes" where the seller collects the tax from the customer and remits the collected tax to the appropriate taxing jurisdiction.

There are different types of sales taxes imposed by the states. Some states are *Seller Privilege Tax* states while others are *Consumer Tax* states. This determines who is primarily liable for the payment of the tax. In *Seller Privilege Tax* states, the seller is primarily liable for the tax. The seller must pay the tax whether or not the tax is collected from the purchaser. The tax is generally imposed on the privilege of doing business in the state. Since the tax is not required to be passed on to the purchaser, it is not required to be separately stated on the invoice. However, most sellers do show the tax on the invoice. Under audit, the state can only collect the tax from the seller. California and Arizona are two of the Seller Privilege Tax states.

In *Consumer Tax* states, the tax is imposed on the buyer with responsibility for collection by the seller. The seller is still required to remit the tax even if it is not collected from the buyer, but it is usually easier to recover the tax from the buyer. The tax is generally imposed on the privilege of using or consuming the products or services purchased. Under audit, the state can collect the tax from either the seller or the purchaser. New York and Ohio are two of the Consumer Tax states.

Gross Receipts Taxes are a type of sales tax. The tax is a percentage of the total dollar amount of the transaction. This includes gross receipts from sideline operations such as occasional sales or sales outside the regular course of business. As a general rule, there are very few deductions allowed under a gross receipts tax structure. In most gross receipts tax states, many services are subject to tax that are not taxed in states that impose a sales tax. Hawaii and New Mexico are two of the Gross Receipts Tax states.

Complementary to the sales tax is the *use tax*. Use tax is defined as a tax on the storage, use, or consumption of a taxable item or service on which no sales tax has been paid. The use tax does not apply if the sales tax was charged. The use tax applies to purchases made outside the taxing jurisdiction but used within the state. The use tax also applies to items purchased exempt from tax which are subsequently used in a taxable manner. There are two types of use taxes—*Consumer Use Tax* and *Vendor/Retailer Use Tax*.

Consumer Use Tax is a tax on the purchaser and is self-assessed by the purchaser on taxable items purchased where the vendor did not collect either a sales or vendor use tax. The purchaser remits this tax directly to the taxing jurisdiction. This is what most people think of when they talk about "use tax".

Vendor or Retailer Use Tax applies to sales made by a vendor to a customer located outside the vendor's state or sales in interstate commerce if the vendor is registered in the state of delivery. Many people also consider this sales tax. However, it is important to make the distinction as differences can exist between the sales tax and the retailer use tax in relation to who has the liability for the tax, the sourcing of the tax and the tax rate. For example, in Illinois the sales tax is an origin tax and can include local taxes. However, the use tax is sourced to the customer delivery location and there is no local use tax that is required to be collected by the seller. Only in the city of Chicago is there a local use tax.

A *sale* is defined as any transfer of title or possession, exchange or barter, conditional or otherwise, in any manner by any means whatsoever of tangible personal property for consideration. The imposition of tax is determined upon the passage of ultimate ownership or title or possession of tangible personal property or a taxable service. A transfer of title is an indication that ownership has been transferred. A *transfer of title* does not require that possession has also occurred. Thus, a sale has occurred when the "right to use" the property has changed hands. An actual change in possession need not occur. A *transfer of possession* is a transfer of control over a piece of property. A transfer of possession, temporary or permanent, may result in a sale. A lease involves a transfer of possession but not of title. Most states include both transfers of title and possession in its definition of sale. Illinois does not. Illinois only includes transfer of title in its definition. Therefore, true leases are not subject to Illinois sales or use tax.

Barter transactions are included in the definition of sale. Therefore, it is important to determine if a non-cash transaction has a sales tax implication. If either side of the barter transaction would be taxable if it had been a cash transaction, a value of the item must be determined. Generally, the person obtaining the taxable item owes consumer's use tax on the taxable value. Before the item is deemed taxable, all possible exemptions should be evaluated, including occasional sale.

Use is defined as the storage, use or consumption of taxable property or services and includes the exercise of any right or power incident to the ownership of the property. Louisiana defines use as "the exercise of any right or power over such property incident to ownership, including distribution." Nebraska defines use as "the exercise of any right or power over tangible personal property incident to the ownership or possession of that tangible personal property."

Some states do not include storage in their definition of use. This generally will exclude from taxation property temporarily stored within the jurisdiction for shipment to and use in another state. This is commonly referred to as "temporary storage exclusion."

Use includes the conversion of property purchased exempt from sales tax that is used in a taxable manner. This includes samples, donations and converted inventory. Most states impose the tax on the cost of property. Therefore, for items removed from inventory that are self manufactured, the material cost is generally the basis subject to tax.

Some states define the tax basis on these items as manufactured costs, and a few states impose tax on the retail selling price. Before assuming the tax is due, verify that no other exemption would apply. ❑

Editor's Note: Diane L. Yetter CPA, MST, is president of YETTER™ (www.yettertax.com), a sales tax services firm. Yetter is a strategist, advisor, speaker, author, and expert witness in the field of sales and use tax. She is also a member of IOFM's Editorial Advisory Board.