Sales Tax: Not Simple

BY SAGE TURNER

I joined the French Broad Food Co-op team in 2009. Sales had been plummeting for five consecutive years. We were broke, losing millions in sales to new competitors, having a hard time keeping inventory on the shelves, and had a bleak outlook. We needed a complete systems review and overhaul, something that would take a couple years to pan out and implement. Deciding which areas to tackle first was a challenge, and receiving notice of a sales tax audit only complicated matters. While we were successful in revamping the store and increasing sales, we had failed to look closely at our Point of Sale system, and it cost us.

Tax rates can be complicated. Each state has either origin-based gross receipt tax (sales tax) or destination-based sales tax, and most are the latter. Origin-based means a tax is applied at the location of the actual sale; destination-based means the end user pays the tax. No matter what happens along the way, the last person to use or consume the product pays. For co-ops, this means the tax is typically collected during the checkout process.

Only 29 of the 172 co-ops listed at ncga.coop are in origin-based states, or approximately one out of five. While most of the information in this article pertains to North Carolina, which has a destination-based tax, details about your state can be found online or by making an appointment at your local department of revenue office.

Not about sales

When we think about sales tax, we must remember to think of it as completely separate from sales. The figures are not reported with gross sales and are not on the income statement. Writing checks to the state has nothing to do with expenses. Taxes are collected and remitted; therefore, they are balance sheet items, reported as monies collected and payable. When you send your tax payment, you simply debit sales tax payable and credit cash.

Where do all the collected monies go? There are typically state and county taxes, and occasionally an additional local tax. All but five states have a statewide tax. The highest of average rates is 9.44 percent (Tennessee); the lowest of averages is 1.69 percent (Alaska). The highest taxes in the nation are in Tuba City, Arizona. They pay an astonishing 13.75 percent, which includes 6.6 percent to a local tribe.

French Broad Food Co-op is in Buncombe County, in western North Carolina. Our current rate is 7 percent: 4.75 percent to the state and 2.25 percent to the county. Fifteen years ago, the rate was even higher, but the state removed its 4 percent food tax, leaving only the counties to collect. Recently, Republican legislative leaders began pushing to instate an 8 percent rate on groceries (up 6 percent from the current 2 percent) to help recoup lost income taxes. Some say it is in hopes of lowering individual and corporate income taxes. Either way, the theory is that food should be taxed because it is not a progressive tax (varies per income) and because grocery spending is dependable. It would add $312 to the annual bill of someone who spends $100 a week.

What does the county do with their portion? Last year, approximately $180 million was collected in Buncombe County sales tax, with funds going mostly back to the state and some going to a local community college. Each state varies in its tax practices.

For resale? Food or candy?

Co-ops frequently work with complicated vendor relationships across many states. If vendors familiarize themselves with the rules and paperwork, they can avoid dealing with sales tax altogether. They simply pass the liability on by purchasing their ingredients without tax, using a resale exemption form; then the co-op purchases from the vendor for resale again, so the vendor doesn't pay tax when selling their product either.

At a store level, the details of taxation get even more complex. Your finance managers and scanning coordinators must understand local laws and stay abreast of any changes. You have to determine which items are considered foods that should be taxed at the food rate (2 percent in North Carolina), versus foods that are taxed at the full rate (7 percent). This may seem obvious at first read, but an audit will find holes in your system every time.

Did you know that bulk chocolate chips are full rate? They are considered candy. Same goes for bulk sweetened coconut, but not your trail mixes that have chocolate chips or sweetened coconut in them: they are taxed at the food rate. Your raw almonds are food rate. Your roasted almonds are not. All those power and protein bars flying off your shelves have different rates, with the main determining factor being whether or not they contain flour. I like to tell startups, "Hey, just throw some flour in there, and save your consumers 5 percent." It's true for all types of flours, so why not?

Utensilitis? Another confusing department for taxation is the deli. The mere presence of utensils or a microwave can alter the tax. If the item is to be heated up or eaten with utensils, it is taxed at the full rate. As a basic rule, any time you combine two ingredients, you are required to charge the full rate. To be clear, if a customer buys some loose carrots and an apple, they pay the 2 percent food rate. But if the deli shreds the carrots and throws in chunks of apple, the rate is now the full 7 percent rate. This means every muffin, cookie, soup, salad, brownie, etc. is at the full rate. Your salad bars and hot bars are entirely full tax rate.

The drink aisle also poses some problems worthy of review. Any and all drinks that are sweetened and/or are less than 50 percent juice content are taxed at the full rate. This includes sweetened waters. The craze of the energy drinks has hit natural foods markets, and all of these type drinks are also full rate.

You can see why the scanning coordinators are so important to the store's systems. I suggest also educating buyers to make sure items are properly coded when brought into the store.

Audit defenses

With such a dependence on tax income, states are focusing more staff time on audits since they often find errors and charge additional penalties and interest. What happens if you get audited? It is time-consuming and costly, but not insurmountable.

Be sure to ask for an audit contract that limits the time frame being audited. This will prevent the state from collecting on historical mistakes outside the agreed-to period.

It is also very important to maintain accurate product movement records and to save these files regularly. If an item was taxed incorrectly, you will be required to prove historical movement and pay all back taxes. The scope of the audit will include purchases for your store. If you buy compostable plates for the deli, they are part of the sales transaction and you do not owe tax on the plates when you buy them. However, if you take soap off the shelf to use in the store, you likely bought it from a vendor tax-free, but now owe tax on it because you are not reselling it.

I suggest always running store supplies through the register, thus creating a record and automatically adding tax. Form NC E500, used to pay sales tax in North Carolina, details receipt totals for supplies used in the store and purchased online. That includes places like Amazon.com, who have not been forced to charge sales tax…yet. I recommend keeping these expense receipts filed together; it will save you time and money if you are ever audited.

To learn more about your state and all the various taxes, visit www.taxfoundation.org. ■