

Not used to use tax?

How to make sure you're paying your fair share

Everyone is familiar with sales tax, but few know of use tax, which is typically imposed on the purchase and use of items and services that are subject to sales tax but for which no sales tax was collected.

Use tax issues often arise in connection with out-of-state purchases. A resident of a state with use tax may purchase taxable goods in another state that doesn't impose sales tax or may buy such goods from an online retailer that doesn't collect sales tax. In either instance, the customer has a duty to pay use tax.

"Use tax is a complement to sales tax," says Andrew P. Sonin, an attorney at Semanoff Ormsby Greenberg & Torchia, LLC. "It's like a safety net, albeit with some sizeable holes."

Smart Business spoke with Sonin about use tax, who has to pay it and how it's collected.

Where is use tax in effect?

Nearly every state, including Pennsylvania, New Jersey and Maryland, has a sales tax and a compensating use tax. Delaware does not have a general sales or use tax — a fact which Delaware businesses advertise to residents of neighboring states. The other states currently without a statewide sales or use tax are Alaska, Montana, New Hampshire and Oregon.

What is the rate?

The use tax rate usually matches the sales tax rate. Pennsylvania has a statewide sales tax rate of six percent, so the use tax rate is also six percent. However, there is an additional one percent local sales tax in Allegheny County and an additional two percent tax in Philadelphia. So if you acquire property subject to use tax, you will owe seven percent in Pittsburgh or eight percent in Philadelphia.

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Who has to pay it?

Use tax falls on whoever uses the product or service, with the responsibility for reporting and payment resting squarely on the purchaser. It affects both individuals and businesses.

Online sales have brought use tax to the forefront. After years of resistance, several online retailers, such as Amazon, have recently reached deals with various states to collect sales tax on online purchases. If an online retailer does not collect sales tax, most buyers will owe use tax on the purchase and use of any taxable goods from that retailer.

How is it collected?

It's a difficult tax for revenue authorities to collect because there is no surefire way to know when and what people are buying. States generally rely on self-reporting and provide forms for that purpose. That is problematic, however, because most people aren't aware of use tax and even if they are, they have little motivation to analyze their receipts, calculate the tax and pay it.

States have dealt with this in different ways. Pennsylvania has a line on its individual income tax return for reporting use tax. Businesses may be audited for use tax compliance if they are already collecting and remitting sales tax.

How is it enforced?

Businesses sometimes face liability when they least expect it. There was a case in New York a few years ago involving a major delivery company that had a practice of giving shipping supplies to its current and potential customers for free. The items bore the company's logo and clearly were provided for marketing purposes. The New York authorities did not see it that way, though, and imposed use tax on the company's purchase and distribution of the supplies. After years of expensive administrative wrangling, the company ultimately required intervention by New York's appellate courts to confirm it had no use tax liability under an exception for promotional materials.

Since enforcing individual compliance is an even greater challenge, revenue authorities tend to concentrate on big-ticket purchases to get more bang for their buck. In one instance, a man bought a boat 'tax free' in Delaware and decided to dock it occasionally in New Jersey. The New Jersey Division of Taxation eventually learned of the situation and, assuming the man to be a New Jersey resident, sent him a use tax assessment with interest and penalties 20 years after the purchase — an example of the state's perseverance in pursuit of a dollar. ●