

**There's an urban myth in the restaurant business** that goes something like this: "I collect sales tax, therefore it's OK to use it from time to time to run my business." However, this line of thinking, to be blunt, is very flawed. Merchants who use sales tax as working capital rarely take time to understand the true cost and potentially catastrophic legal pitfalls until it's too late. Merchants may be wondering, why isn't it OK to use sales tax to operate the business until it's time to remit that money to the state?

**The answer is simple: sales tax is not working capital;** rather it is a trust tax. It belongs – at all times – to the State! Business owners and operators have a legal and fiduciary responsibility to the State to hold sales tax secure and in trust. As a matter of fact, owners and operators can be (and often are) held personally liable and responsible for unpaid sales tax debts. Yes, this means the State can come after the owner/operator personally if sales tax isn't remitted on-time and in full.



**Businesses are legally obligated to collect sales tax as part of their sales,** and those taxes are deposited into the business checking account with the daily card settlement and cash deposit. Once funds are deposited, sales tax and working capital are co-mingled making it hard to keep track of what's what. Having a bank account that is slightly inflated by a few thousand dollars of sales tax every month makes it easy, not to mention tempting to use this extra revenue to pay bills. But when the sales tax payment comes due to the State the next month, merchants struggle to come up with \$5,000 or \$6,000 dollars to pay it. Quite often this puts them between a rock and a hard place facing a decision to keep the lights on or pay sales tax. Most owners opt to keep the lights on and the doors open and naively worry about sales tax later. Doing so poses both legal and financial consequences. On the financial side, few owners realize that they are actually taking a short-term loan from the State and they fail to consider or calculate the true cost of

borrowing sales tax revenue to fund their business. On the legal side, far worse than that, in some instances the State may consider this to be a criminal act!

One merchant recently explained that he couldn't survive without using sales tax revenue to run his business. When asked if he had ever paid his sales tax late or had he ever calculated the true financial cost of "borrowing" sales tax to run the business, he explained that he often paid late, but had never really stopped to consider the financial costs involved. That urban myth persists for many merchants who use sales tax as working capital and pay the price over and over. They waste valuable resources and squander hard earned profits on avoidable penalties and interest.



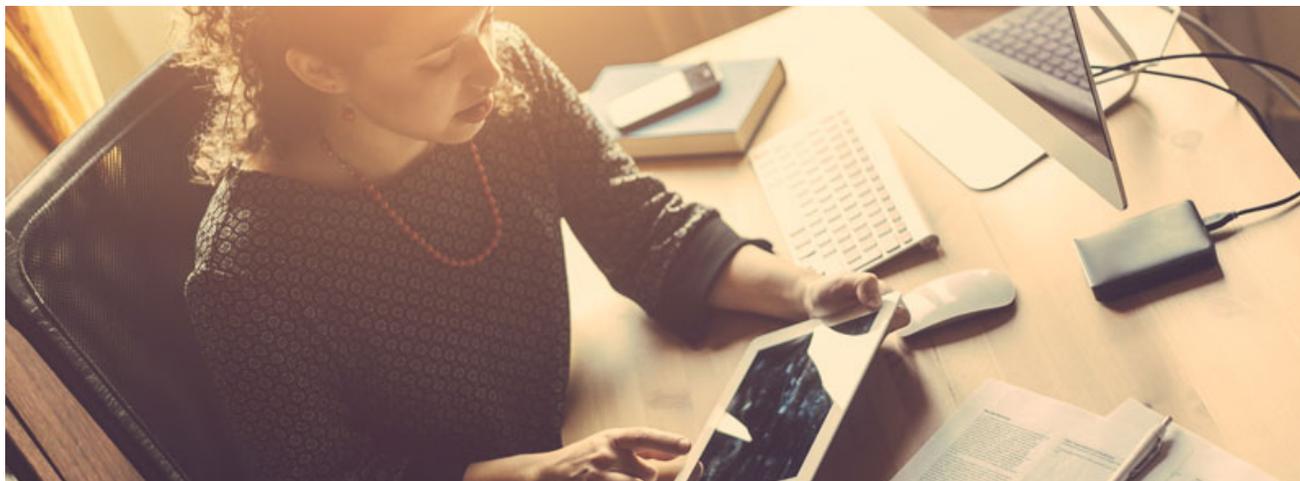
**Setting aside the significant legal risks for just a moment**, what are the financial costs of using sales tax money to run a business?

There are a number of issues to un-pack here. First, let's understand how much they are actually borrowing. If a business collects \$4000/month of sales tax, that's not what they borrow because the entire amount isn't deposited into their account as a lump sum on the first of the month. Instead it's collected and deposited daily throughout the month, 15 days in and 15 days out. This makes the true value of the amount borrowed about \$2000 or half the total amount of sales tax collected.

Second is the cost of borrowing. States attempt to keep merchants compliant with excessive penalties and interest rates for missed or late payments. Sales tax payments are due on specific days and times which vary state by state and there's no grace period like a mortgage or credit card bill. When the state says the 20<sup>th</sup> of the month by 5pm, they mean it. One minute late results in the assessment of penalties and interest which can run as high as 25%. What merchants fail to understand is the interest rate is actually much higher than 20 or 25%. Let's use the example above with \$4000 of sales tax, borrowing \$2000 for 30 days and missing the next month's sales tax payment. Let's say the business is located in California where the penalties are 10% for late filing and 10% for late payment. The total penalty would be 20% of \$4000 making the total amount of sales tax plus penalties \$4800. The merchant only borrowed \$2000, but the penalties were assessed on the total amount of sales tax due, \$4000. That short term \$2000 loan cost the merchant \$800 of penalties or 40% interest for about 30 days!!! Good deal? Not really considering the average interest on an unsecured credit card or line of credit is about 16%.

Unfortunately in many cases like this, the saga doesn't end here. Instead this is the beginning of a very long uphill battle for the business to get back on track. Quite often a missed sales tax payment gets forgotten because it's out of sight out of mind and the next month rolls around and another \$4000 of sales tax is due making the two month total \$8800. The merchant's behavior doesn't change and sales tax continues to be used as working capital and the next payment is missed and the total of sales tax, penalties and interest due goes north of \$9600. It's easy to see where this is going because the business is only grossing about \$50,000/month and now 20% of their sales will go to paying back sales tax owed. Unless the business has revenue increasing exponentially, month over month the chances of catching up diminish quickly and the business is headed off a cliff.

**Remember merchants are personally liable for unpaid sales tax** and in many cases such as this, merchants end up needing professional legal help to avoid a bad ending. Tax auditors and tax collection agents have a job to do, and they mean business. They must be dealt with squarely and promptly or matters may likely spiral out of control. It's much better, and cheaper, to operate the business properly and minimize the risk of audit by filing and paying correctly and on time.



**Face it, nobody opens a business to be a tax collector for the State.** But when a business is created, it's assigned a tax ID number, issued a sales tax license, and the owners or operators are conscripted by the State to charge, collect, and remit tax. Entrepreneurs open businesses to follow a passion, be successful, and earn a living, not collect and disburse taxes, but that is precisely what the law requires. The financial and legal costs of mismanaging sales tax are high and potentially fatal to a business (as well as its owners and operators personally) if left unchecked. Merchants work hard for every penny of profit and wasting profits on penalties for mismanaging sales tax is foolish. If cash management and fiscal discipline are not the business owner's strength, they should outsource sales tax management to a third party and have a professional manage it for them, same with payroll.

There are several options for managing sales tax including bookkeepers, accountants, and tax filing services, but unfortunately these options rarely solve the problem of making sure sales tax is not used as working capital. DAVO Technologies has pioneered the process of daily fractional funding and developed an application that solves the problems associated with the mismanagement of sales tax. The DAVO Sales Tax app automatically sets sales tax aside daily as it's collected and files and pays it when due, on-time, and in-full. DAVO enables business owners to forget about sales tax and do what they do best, follow their passion, engage with their customers and run a successful thriving business.

---

**Disclaimer:** *The information contained in this article does not constitute tax advice and is for informational purposes only.*

**If you are reviewing your company's sales tax practices and want to consider whether DAVO may be the right fit for you, you can [email David](#).**

*David Joseph is the chairman/co-founder of DAVO Technologies, based in Portland, ME. David spent almost 20 years in the restaurant business and has a deep understanding of the challenges faced by business owners. He and his partner started*

**If you are already facing a tax audit or dispute, you can [email Lance](#).**

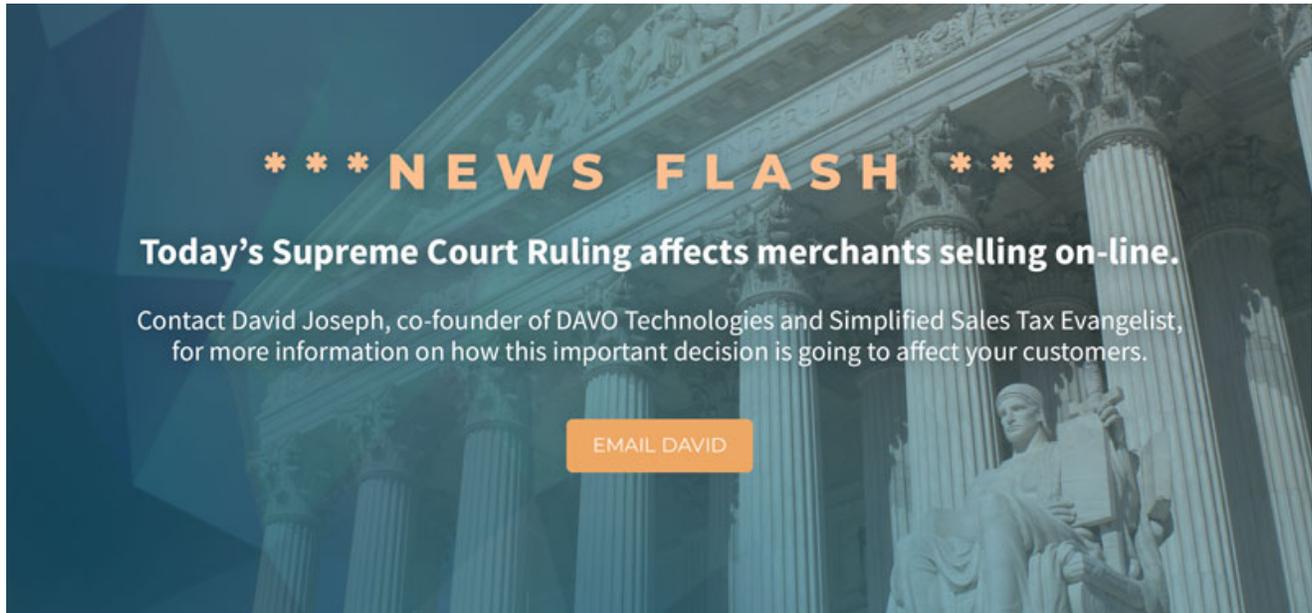
*Lance E. Rothenberg is a tax attorney and is Of Counsel with Tenenbaum Law P.C., which is based in Melville, N.Y. Lance focuses on state and federal tax controversies and disputes, and he has experience assisting a wide range of businesses and*

*DAVO with the goal of automating sales tax compliance, making it seamless and automatic. DAVO has developed a suite of finance apps that use daily fractional funding to help merchants grow and succeed through better cash management.*

*business owners facing federal, state, local, and multistate tax issues, including sales-and-use taxes, corporate income taxes, personal income taxes, and excise taxes.*

EMAIL DAVID

EMAIL LANCE



**\*\*\* NEWS FLASH \*\*\***

**Today's Supreme Court Ruling affects merchants selling on-line.**

Contact David Joseph, co-founder of DAVO Technologies and Simplified Sales Tax Evangelist, for more information on how this important decision is going to affect your customers.

EMAIL DAVID

2018 © DAVO Technologies | All rights reserved



DAVO Technologies 565 Congress Street Portland ME 04101 USA

You received this email because you are subscribed to Marketing Information from DAVO Technologies .

Update your [email preferences](#) to choose the types of emails you receive.

[Unsubscribe from all future emails](#)