MARKET REPORT

Sales Tax Audit!

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This description of a sales tax audit is an opportunity to minimize potential problems with sales taxes. While focused on Minnesota much of it applies to any state with sales taxes. Do not construe this article as legal or tax advice.

I am a believer that the best kind of bad experience is second hand. This article is your opportunity to have a second hand bad experience and minimize your own potential problems with sales taxes. While this happened in Minnesota much of it applies to any state with sales taxes. This article can give the reader ideas as to items to inquire about in each state where your company has an owned or managed hotel.

Upon receiving notification that, due to random selection, one of our hotels was being audited for state sales and use tax compliance, we worried, we planned and worried some more.

Not because we were hiding anything but simply because that is what one is supposed to do before a government audit! As the big day approached the auditor called and asked to a delay as he was running late on another audit. Good, more time to worry! At the last minute we had to ask for a delay because our CFO was ill and it was kindly granted. Maybe we shouldn't have asked. On the appointed day the auditor called in sick! More time to worry!

Finally, it starts and after a few hours, it becomes apparent that every invoice for the past three years will be looked at one at a time. Every room rental of a month or more where we didn't collect sales tax would be looked at. Every regular rental with a tax exempt certificate would be examined. If a transaction of any kind occurred, revenue and purchases, it would be looked at! Finally when it was over on about $5 million in transactions, we owed about $6,000 including interest! It could have been worse.

Use tax was one of the first things that came up. Use tax applies when you purchase taxable items or services without paying sales tax to the vendor. The rate is identical to sales tax and in some cities there is a use tax in addition to the state use tax. The tax is based on the cost of the taxable purchase.

It is fairly obvious that you pay a use tax on items purchased anywhere and used in state for which the vendor didn't charge a sales tax. However, did it occur to you to pay a use tax on items bought in other states where a lower sales tax than your state's was charged. Buy in one state with a 4% tax? Then in Minneapolis you'd have to remit 2.5% use tax to the state and 0.5% use tax to the city! There are other times but those are the biggies.

Sales tax must be charged on lodging furnished for periods of more than 30 days if there is no enforceable lease agreement with the guest for a specific room. The lease agreement must require that the lessor and lessee give prior notice of their intention to vacate. It must be a specific guest not a company who uses it for several different employees.

Other items for which hotels must show sales taxes separately on the folio or state specifically that they are included in the price include: in-room movies; copier (but not fax) services; food and liquor from an in-room courtesy bar; game

(pinball, pool, jukebox, etc.) receipts; laundry or dry cleaning services (coin operated are not taxable); no-show charges; parking fees and car wash charges; popcorn prepared by the vendor; rental of equipment (primarily meeting room equipment if billed separately from non-taxable meeting room charges); rental of recreational equipment; telephone access charges, but not the actual cost of the service if shown separately; and a lot more things!

Here are some items which can be treated in unique ways. A telephone call accounting system doesn't show what the actual service costs. In this case charge a sales tax on the total and pay the sales tax shown on the phone bill from the vendor. The hotel is allowed to take an adjustment to the taxable amount reported on the sales tax return by the amount they are billed by the phone company for the actual costs of the guests' long distance calls. This can only be done if you can separate administrative calls from guest calls!

Some miscellaneous items. Whoever removes the coins from a machine is usually the one responsible for sales taxes. In a gift shop food, candy, soft drinks, clothing and health products may all be taxed at distinct rates. Gift certificates are not taxable and are treated as cash. The tax is charged when the recipient uses it. Items sold subject to the discount on a coupon are taxed at the discounted price unless you are being reimbursed for the amount by a third party. In Minnesota all equipment leased or purchased to provide lodging is taxable. If the vendor does not collect sales tax you must pay a use tax. Consumable supplies purchased by hotels are taxable. Food products are not, except for candy and soft drinks (containing less than 15% fruit juice - watch those labels) or food purchased from a caterer or restaurant! Please interpret that without calling me. Oh yes, if you are a restaurant some of those consumable items like place mats and paper napkins are not taxable. I'm not sure why toilet paper and tissues in hotels are treated differently for tax purposes, but they are! By the way the toilet paper would probably be exempt from sales tax both at time of purchase and sale if it were noted separately on the folio. (Smiling here!) Some states have been successful in convincing their legislatures that a hotel's consumable items are actually resold in a package rate (the room rate) but none has challenged their status in Minnesota although it would save us considerable sums.

Supplies for repair or redecorating are taxable if they are purchased without installation. So have the UPS delivery person slide those ACs right into that sleeve and save sales tax. Seriously, you may realize a savings buying items installed by the vendor or a contractor. On the other hand, postage and shipping charges separately stated on an invoice are not taxable. Handling charges, whatever that really is, are taxable! If your vendor calls the shipping charge "shipping and handling" even it really is just shipping, then that entire line item is taxable. As you can see none of this is easy to follow, let alone get vendors from various states to do properly for your state as their state laws may tax them differently.

Here are a few items for which no sales tax needs to be charged: missing or damaged items; coat check; meeting room or hall rental; valet service (I'm not sure how this is different from laundry and dry cleaning service which some hotels call valet service which is taxable); and rented space (such as restaurants, barber shop or car rental booths) except for the use of the equipment in it.

What about the exempt status of government agencies and non-profits? One of the items we didn't do as well in as we thought we should because we had worked on it so hard was tax exempt certificates from various charities and government agencies. Sure, we knew the federal government was only tax exempt when it was billed directly with a government credit card. Well, it isn't so simple. It is tax exempt if it is the I.M.P.A.C. Visa card. If it is a federal government Amex card its first four digits will be 3783. Now here is the trick - If the fifth digit is a 7 or 8 charge sales tax but if it is 9 do not. If the fifth digit is anything else I'm not sure what you do! And, try getting a hurried and harried Guest Service Agent to comply with these rules. (Please double check the information provided in this paragraph as it may have changed.)

Sales billed to and paid directly by tribal governments are sales tax exempt. If someone tells you to bill the tribal government and then pays you with a personal check you probably must pay the sales tax out of your receipts. My interpretation of this is that if a management company is handling the tribe's money it is not sales tax exempt as the information states, "paid by tribal government", there is no reference to their agents. Of course if it is a local occupancy tax that the state does not handle, then the state doesn't care.

State and local governments of all kinds must pay sales taxes. Local governments are not required to pay local general sales taxes but may be required to pay other special restaurant, liquor or lodging taxes imposed by local governments. My theory is, if in doubt collect it and pay it to the state rather than get in trouble.

Lodging is taxable when sold to non-profit organizations and school districts or their personnel, even when billed directly to the school or non-profit organization. A Certificate Of Exempt Status, Form ST-17, cannot be used to purchase lodging exempt from sales tax. And, representatives of these organizations, thinking they are entitled to tax exemption will be very "forceful" with you staff.

Foreign Consular Officials receive special cards from the U.S. Department of State's Office of Foreign Missions. The cards have the diplomat's picture and other identification and clearly state on the back what exemptions they are to receive. Read those and if they qualify note the I.D. number of the folio.

Now just to make sure you're on top of this, here is the test question. If a hotel in Minneapolis buys supplies outside of Minneapolis, such as a hardware store in Hennepin or Ramsey Counties, what is the sales tax impact on the hotel? The hotel must keep track of all those purchases and remit 0.5% use tax to make up for the higher sales tax in Minneapolis! Keeping detailed records of these purchases is no small burden on a hotel. Trust me, the auditor found every 0.5% owing for three years! Another example is if the owner of the hotel visits New Hampshire which has no sales tax and buys a lovely decorative item for his hotel on his credit card, thereafter getting reimbursed by the hotel for this expense, the hotel must remit the 6.5% or 7.0% to the state.

So, what happened as a result of our audit? The auditor stated that their goal was more one of education rather than collection and punishment or, as he put it, it is a "kinder, gentler Revenue Department". While all our rentals for more than 30 days were audited and found to be lacking a satisfactory lease agreement, they offered us a deal. If we agreed not to appeal the amounts in the audit they would charge us sales tax for only three of the 36 months on those 30 day rentals. We agreed and they picked the highest ones! We were still ahead. In addition, of course, we were charged all the unpaid sales and use taxes on purchases that were found (no deal there) and they found them all because every single invoice we paid for three years was examined. We were charged interest but no penalties because it was apparent that there was no intent to defraud the state. Or as one of our office humorists said, "We were just stupid."

For information that is more accurate contact the state’s tax division and ask for a Sales Tax Fact Sheet, or its equivalent. Another excellent source of information regarding government regulations that affect the hotel industry is a state’s hotel association. Generally, the information is only available to members but it is worth the membership dues in savings alone! Please do not construe this article as legal or tax advice and in other states call your tax authorities for applicable details, as many are different.