

# State & Local Tax Alert

## COVID-19 and Sales/Use Tax Issues to Consider

As COVID-19 threatens the physical and economic health of the nation, several states and localities have been proactive in providing businesses relief with respect to upcoming sales/use tax filings and payments. We expect many states and significant localities to release guidance in the coming weeks in varying formats. In this alert, we highlight three important areas addressed by the guidance released so far that should be closely evaluated by businesses: (i) deferrals of sales tax filings and payments; (ii) treatment of the use tax; and (iii) required prepayments of sales tax.

### Deferrals of Sales Tax Filings / Payments

Some states are providing for deferrals of sales tax filings and payments in varying ways. For example, Illinois has instituted an installment payment schedule requiring that with respect to certain qualifying taxpayers (generally, operators of small eating and drinking establishments), 25 percent of the liability for the February through April 2020 reporting periods will be due on May 20, June 22, July 20 and August 20.<sup>1</sup> In contrast, Maryland has provided a more expansive deferral to file and pay the sales tax for the February, March and April tax periods from the 20th of March, April, and May, respectively, to June 1, 2020.<sup>2</sup> Minnesota provided relief by extending the time for which a business must pay the sales tax for February 2020 from March 20 to April 20, though the state did not extend the time for which the February 2020 return had to be filed.<sup>3</sup>

Deferrals generally result in an elimination of interest and penalties that otherwise would apply when a sales tax filing and payment is late. It should be noted that to the extent a state or locality has not provided deferral relief, or such relief is insufficient, businesses generally may request such relief by showing reasonable cause.

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<sup>1</sup> "Short-Term Relief from Penalties for Late Sales Tax Payments Due to COVID-19 Virus Outbreak," Illinois Department of Revenue, Mar. 2020, published at <https://www2.illinois.gov/rev/research/publications/bulletins/Documents/2020/FY2020-23.pdf>.

<sup>2</sup> Maryland Tax Alert 03-20, "Impact of COVID-19 on Maryland Tax Filing," Maryland Comptroller, Mar. 20, 2020, published at [https://www.marylandtaxes.gov/schedule/pdf/COVID-19\\_Tax\\_Alert.pdf](https://www.marylandtaxes.gov/schedule/pdf/COVID-19_Tax_Alert.pdf).

<sup>3</sup> "Our Response to COVID-19," Minnesota Department of Revenue, Mar. 18, 2020, published at <https://www.revenue.state.mn.us/sales-and-use-tax>.

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Sales/Use Tax

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While many businesses will welcome the deferral relief that has been provided by some states and localities to date, a deferral of sales tax payments does not mean that the collected funds should be used to maintain the cash flow of a business. As tax collection agents of the states, businesses are strongly urged to segregate the collected sales tax in an account that is not used to operate the enterprise. Failing to remit collected funds when due may lead to personal or even criminal liability for officers of a business.

### **Use Tax**

In some instances, a business does not pay sales tax when it purchases an otherwise taxable product, for example when the business purchases the product from a remote seller that does not meet the economic threshold test to be required to collect the sales tax. When this happens, the purchaser is required to pay the complementary use tax to the jurisdiction in which the product is actually used. Since the relief being offered by states and localities typically accounts for both sales and use taxes, a purchaser that must file and pay use taxes should consider whether such product will actually be used where intended given current business uncertainties. If so, use tax liabilities should be segregated to ensure that such amounts are not treated as part of cash flow.

### **Prepayments**

Many states require businesses to prepay sales taxes each month, based on the expected volume of sales that they expect to make over the course of the month or based on a safe harbor percentage of historical collections. Deviations from the expected volume of sales, which cause overages or shortfalls in sales tax, are reconciled when the sales tax return is filed in the following month. A shortfall often results in the imposition of interest and penalties.

As a result of dramatically reduced business activity caused by the onset of COVID-19, some businesses may have overestimated their expected volume of sales, resulting in an overpayment of sales tax that will not be obtained until the sales tax return is filed in the following month. On the other hand, other businesses may have drastically underestimated their expected volume of sales, as a means to limit the amount of the prepaid sales tax submitted to the state. Given the uncertainties with respect to prepayments, it is not surprising that some states are providing businesses leeway in this area. The Pennsylvania Department of Revenue is an example of a state tax authority that has addressed the prepayment issue by waiving penalties for businesses required to make prepayments of sales tax on March 20, in addition to waiving the requirement to make a sales tax prepayment in April.<sup>4</sup>

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<sup>4</sup> Alert, "Waiver of Penalties on Accelerated Sales Tax Payments," Pennsylvania Department of Revenue, Mar. 20, 2020, published at: <https://www.revenue.pa.gov/Pages/COVID19.aspx#AcceleratedSTPrepayments>.

### Commentary

Businesses need to be especially cognizant of the sales tax concepts of deferral and prepayments, along with the application of the use tax, as COVID-19 continues to impact state tax liability and cash flow. With respect to deferrals, businesses must be careful to ensure that money intended to be used to pay the sales tax remains that way through the next several months. The sales tax deferral provisions, which do not serve to abate the tax collected or due on transactions, stand in contrast with income tax relief provisions, which often enable businesses with tax reductions or credits for amounts that would otherwise be due, helping cash flow. As far as prepayments, some states provide flexibility with respect to the amount that must be paid prior to the end of a tax period, and we expect that states may continue to provide relief as transactions subject to the sales tax wane over the short term. We will continue to track these developments closely as guidance is released and aim to assist businesses in evaluating the novel sales tax issues that are developing in real time.

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