PRODUCT & SERVICE GUIDE

How Sales Tax Impacts Cash Management

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Shane Ratigan • Feb. 17, 2017

Even profitable companies can have problems with cash flow. Although some stem from external sources and are beyond control, many can be addressed by making adjustments to internal processes. The way companies handle sales tax can impact cash management in a number of ways.

Paying tax before it's collected

In an ideal world, sellers would never be required to remit tax that hasn't already been collected from customers. Unfortunately, real life is far from ideal. For many businesses, sales tax returns may be due before payment from customers has been received. This can cause cash management problems.

Embracing technology can increase cash flow by shortening the gap between invoicing and Accounts Receivable. Electronic delivery of invoices speeds up the billing process, while vendor portals permit immediate payment. These solutions can also improve reporting.

Switching from accrual basis accounting (sales tax is reported when a customer is invoiced) to cash basis accounting (sales tax is reported when payment is received) may give a seller more breathing room. Accrual accounting provides a more accurate account of a company's finances, and it may be required by some states (e.g., California). However, it can put a strain on cash flow. If the cash method is an option, it may be the better choice.

Early payment discounts

Early payment discounts encourage prompt payment, which improves cash flow. Yet they also can affect the taxable amount of a sale. Since states have different policies regarding the tax treatment of early payment discounts, it's important to know the policies in place where you do business.

Generally, cash discounts allowed by a retailer and taken by a customer at the time of sale — such as employee, trade, volume, and wholesale discounts — are excluded from the taxable sales price. Yet early payment discounts, which occur after the close of the sale, often don't reduce the taxable sales price. This is the case in New York.

Understanding state tax policies and predicting which customers will take advantage of early payment discounts improves the overall cash management of a business.

Returns and refunds

If returned merchandise has an upside, it's that the returner may make additional purchases. More often, returns and refunds are merely a pain point for sellers — and at no time is that more true than the weeks following the holidays. Refunding sales tax after it's already been remitted to tax authorities can stress any cash management regime.

The tax treatment of returns varies by state. In Connecticut, for example, a customer is entitled to a full refund of sales tax from the retailer if the goods are returned within 90 days of the date of purchase with a receipt showing the date of purchase and the tax paid (any applicable restocking fees reduce the amount of the refund and the sales tax refund). Goods returned after 90 days or without a receipt aren't eligible for a sales tax refund. California has a slew of rules regarding the tax treatment of returns, particularly with respect to motor vehicles.

Returns and exchanges happen. Forecasting and planning for them can help alleviate the tax pain they cause.

Sales tax compliance drain

Change is one of the most constant aspects of sales and use tax. In 2016, there were 385 sales tax rate changes and 26,168 changes in product taxability. For example: Louisiana temporarily reduced or suspended a number of sales tax exemptions; North Carolina expanded sales and use tax to numerous previously exempt services; a handful of states decided to exempt tampons and sanitary napkins; and several cities enacted special taxes on soda.

New policies could cause consumers to alter spending habits, thereby reducing sales. Furthermore, rate increases and new taxes on previously exempt products and services can strain cash reserves when sales and use tax returns must be remitted before accounts have been paid.

Yet an even greater risk is the drain that simply accounting for changes can have on a company. Businesses need to ensure all applicable sales and use tax changes are recognized, understood, and instituted in a timely manner. It can take an inordinate amount of time: According to a study by Wakefield Research, companies' accounting teams spend an average of nine hours per week filing sales tax returns and remitting payments. That's an enormous resource drain.

Implementing tax automation software reduces the amount of time (and therefore money) companies must devote to sales and use tax compliance, while increasing accuracy and reducing late payment penalties. That's smart cash management.

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