

Tax due on Internet and out-of-state purchases

Dear client:

If you purchase merchandise from a vendor located outside the state or the country, you may owe California use tax. This includes purchases you make over the Internet. When we prepare your taxes, I will be asking you if you made purchases outside of California because you can pay the use tax with your income tax return.

Use tax is like sales tax but you pay it directly to the state, rather than to the retailer. The rule of thumb is: You owe use tax if what you bought would have been subject to sales tax if you purchased it at a local store and you did not pay California sales tax. You generally owe California use tax when you use, store, or consume — in California — tangible personal property purchased from an out-of-state vendor. If the vendor does not collect the California tax on the purchase, the purchaser must pay the tax directly to the state. If you don't report and pay your use tax in a timely manner, such as with your income tax return, the state will assess penalties and interest.

What is and is not subject to sales and use tax can be complicated. There are numerous exceptions to the rules, but here are some common ways that people make out-of-state purchases that are subject to use tax:

- Internet purchases
- Foreign purchases
- Shopping channel purchases
- Mail-order purchases

These are some common examples of items subject to use tax:

- Clothing
- CDs and books
- Computers, cameras and other electronic equipment
- Toys
- Household items such as small appliances
- Makeup
- Over-the-counter medications
- Collectibles
- Jewelry
- Sports equipment
- Computer programs shipped on a disc

Items that are exempt from sales tax are also exempt from use tax. Here are a few examples:

- Music and other online media purchases for your iPod or MP3 player and transferred directly over the Internet.

- Software that is transferred over the Internet and nothing is mailed to you
- Prescription drugs
- Newspapers, magazines, and other periodicals
- Most food items
- Purchases where the seller added California sales tax to your purchase

What if another state sales tax was paid?

If you are required to pay, and did pay, another state's sales tax on the purchase, you may be able to take a credit against the California use tax due. So, for example, if you paid 7% sales tax to another state, you are only required to pay the difference between the 7% your county's rate.

Why use tax and why now?

The use tax is intended to protect California merchants who otherwise would be at a competitive disadvantage when out-of-state vendors make sales to California customers without charging tax.

With the advent of Internet purchases and an increase in people buying from mail-order businesses, California has experienced a loss of sales tax revenue. Use tax is not new, but most people were not aware that it existed.

So, the state has created a campaign to educate people and is starting to actively pursue people who don't pay use tax.

How do you pay the use tax?

If you do not have a California resale permit, you may either:

- Pay the use tax on your California income tax return; or
- Fill out California's **Individual Use Tax Return**, Form BOE-401-DS

I have copies of the Form BOE-401-DS in my office should you decide to pay any use tax you owe separately from your tax return. Or, if you prefer, I will add the use tax to your income tax liability.

I will be asking you about use tax when you come in this year. I'll be happy to answer any questions you have about use tax and will either include it on your tax return or provide the state form if you prefer to pay it yourself.

Thank you for your business and I will be happy to answer any questions you may have.
Sincerely,

Flavin & Associates, Inc.