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BACKTALK

Sales Tax Lawsuits Target Retailers



Suits benefit class action law firms, not retailers or consumers.

BY MARVIN KIRSNER • Greenberg Traurig, LLP

Retailers should be aware of a disturbing trend in consumer class action litigation — lawsuits against retailers that collect more sales tax than required.

Class action law firms are filing such cases on behalf of customers who may have been charged only pennies more in sales tax than they should have been. But retailers can take defensive actions to avoid falling into a potential litigation trap.

Retailers typically remit all such taxes to the proper taxing authority; the retailer does not profit from over-collection. The class action law firms claim that retailers are breaching their duty to their customers to calculate both the correct tax rate and whether every item is subject to sales tax.

Bewildering rules can leave a retailer uncertain whether to collect tax. For example, many jurisdictions exempt the sale of food and bottled water, but not candy or soft drinks. At what point does a food item become candy that is subject to tax? At what point does water become a soft drink? Most jurisdictions impose a tax on books. But some do not charge tax on Bibles. So should a book that analyzes biblical text be taxed? How about the Koran? Making matters worse is the increasing popularity of “sales tax holidays,” particularly around back-to-school. The array of items that are exempt for a short period, and only up to a fixed dollar amount per item, often leads to confusion. Furthermore, simple software glitches might cause the cash register to ring up tax on a non-taxable item.

When something is in a grey area, the natural tendency is to err on the side of caution and to collect tax. To do otherwise might result in a determination by the tax authority that tax should have been collected—resulting in liability on the part of the retailer to pay the tax, interest and penalties. In recent years, states have taken a very aggressive stance on sales tax audits, for a very practical reason—they really need the money. This leaves retailers stuck between revenue-hungry taxing authorities and industrious class action lawyers.

This is not to say that the class action lawsuits end up with judgments against the retailer/defendants. Some recent Appellate Court rulings have been made in favor of the retailer. A Louisiana court dismissed a consumer class action suit against Wal-Mart for over-collecting tax on the sale of pre-paid telephone cards because the taxes were paid over to the Department of Revenue. The Supreme Court of Alabama decertified a class action against GMAC for collection of the incorrect local tax on trailer rentals.

But an Illinois court allowed to proceed a class action case against Nextel for collecting municipal telecommunications tax from customers who lived outside the city limits (but whose post office address indicated they lived in the city).

The problem is that even where a retailer is successful in having a class action case dis-

missed, the legal fees in defending such cases can be enormous. And the cost of sending 60 cent refund checks can exceed twice the amount of the check when processing and postage are included. Plus, many states do not allow the retailer to obtain a refund of the overpaid tax because rules in these states require the consumer to file the refund claim.

What steps can a retailer take to avoid being a defendant? First, the tax department should undertake a comprehensive review of grey area tax items or tax rates. The tax department should put all items into a report which should be reviewed by independent tax advisors. Asking an outside tax advisor for a second opinion can re-open the issue for a thorough discussion of the risks in collecting or not collecting the tax.

Step two would be to request a ruling from the applicable tax authority if there are any grey area issues that the independent advisors are unable to resolve. If the ruling concludes that an item is not subject to tax, the retailer can stop collecting on such merchandise and no longer be concerned with liability to the tax authority for failure to collect. If the ruling concludes that tax should be collected, this should be very persuasive to a judge in deciding whether to allow a case to continue.

Step three would be to test and re-test the software at the cash register that determines what is taxable. Several real life tests should be performed where a “fictional” customer comes in to purchase a market basket.

In step four, clerks should be trained not to respond substantively as to why an item is taxed. Inquiries should be forwarded to management. Finally, and most importantly, checks and balances should be implemented

to make certain that every single cent of sales tax collected is properly remitted to the appropriate tax authority. A court would be much less inclined to view a retailer in a good light if the retailer inadvertently kept any tax that was over-collected.

For a more long-term solution, retail trade groups should lobby state legislatures to limit such class action cases. The class action counsel, and not consumers, truly benefit. A careful review of tax policies would be an ounce of prevention to stay out of such a trap.



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