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When Past-Due Bills Seem Unfair

You can't be indefinitely liable for a vendor's shoddy accounting, says a financial pro. More crucial is the importance of your business relationship

By [Karen E. Klein](#)

A Texas software vendor we have purchased from for years got audited by the California State Board of Equalization because they never billed for use tax. After the audit, they sent us a past-due use-tax bill, which we paid right away. Now, months later, they send us an invoice for interest due on past-due use tax. I would like to assert that their failure to stay in compliance is their responsibility, including the outstanding past-due interest assessed by the California BOE. Do I have a leg to stand on with this position? —D.C., Chatsworth, Calif.

You probably are in the right in declining to pay the interest on use tax that was not properly collected by your vendor, according to tax experts. Whether you choose to assert that position, however, or simply pay the invoice is likely to depend on how much money is at stake and how important this vendor is to your company.

"You should not be liable for past-due interest for two reasons: First, you paid the invoice as submitted in a timely manner," says James H. Suits Jr., a certified financial planner and president of [Summit Capital Advisors](#) in Tacoma, Wash.

"Second, it is beyond imagination that you should be indefinitely liable for their lack of accounting procedures. Suppose everyone started going through their books and auditing them from years back to identify their mistakes and then billed their customers or clients for the additional principal, interest, and penalties. When, exactly, could a business be confident that their responsibilities were satisfied? When could they close their books? How would they manage their cash flow?"

Brad Graves, a CPA and partner in charge of tax practice at [Haskell & White](#), an accounting firm in Irvine, Calif., agrees. "It's doubtful that your company would be legally liable to pay interest or penalties for the Texas company's failure to collect use tax," he says. "The Texas company is the one that didn't follow the law."

DO YOU NEED THE VENDOR?

The larger question, he says, is how important this vendor is to your business. Is it integral as a long-term supplier, or can you source the software you need from another company for the same price and level of service? Will a new vendor be as reliable as this one? "If you leave the vendor hanging—even though it was their responsibility to pay [the tax in a] timely [manner]—they will be hurt by that, and it's likely to sour your relationship with them," Graves notes.

It's possible that this episode has soured the relationship on your end as well, and perhaps rightly so, Suits says: "We've been in the position of realizing that we underbilled accounts in the past. In every instance we wrote off the amount unbilled and considered it a learning experience. It serves to cement the client relationship better when the client knows they are truly being treated fairly."

Scenarios like yours are likely to be more common as [cash-poor states become more aggressive in their collection of use tax](#) and [efforts to establish national legislation requiring online retailers to collect state sales tax heat up](#).

COMPLIANCE IS KEY

Already, it is not uncommon for California and other sales tax states to audit out-of-state companies that have a legal "nexus"—a sales office or technical support employees, for instance—in their states, Graves says. "The states are battling for this money, and it is fertile ground, especially with all the budget problems they are having," he says.

Companies that have national customers and may not have collected use tax in recent years should investigate the voluntary disclosure programs offered by most states, he recommends. Such programs typically allow businesses that are out of compliance to pay uncollected use tax for the previous three years without penalty or interest.

Along with catching up on the past-due taxes, the agreements close the statute of limitations on prior years' taxes, something that could be quite valuable to companies that have never followed use tax procedures properly.

"Get compliant. If you don't, the statute of limitations is potentially open for any year in which you have not filed a use tax return," Graves says.

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