

# The Hidden Tax Implications of COVID-19 Surcharges

08.04.20

In today's COVID-19 world where nothing seems normal, and "new normals" are popping up in every business operation, service businesses are trying to make up for lost income and rising expenses in creative ways that will lessen the financial impact of COVID-19.

One way that is attracting a lot of unexpected negative attention is tacking on an additional charge to a customer's receipt and labeling it "COVID-19" or "sanitation" (for the extra measures required to avoid the spread of COVID-19). Since business owners have reduced the amount of seating, invested in additional cleaning products and hand sanitizers (and in most cases, much more), they are hoping their customers will sympathize with their financial plight and be more than happy to pay the surcharge, no questions asked. Not all customers are empathetic, however, and even take out their displeasure on employees of the business, as if the employees are responsible for the unexpected surcharge on the bill.

What business owners may not realize is they may unknowingly be creating headaches and additional expenses that may eat into a large part of the additional revenue possibly generated. The new COVID-19 surcharge may just be the trigger for a sales tax audit that state tax authorities are looking for to generate the tax assessments they need to close anticipated budget shortfalls during the pandemic. The last thing a struggling small business owner wants to see is a sales tax audit of their business, post-COVID-19.

Why would a COVID-19 fee be a beacon for a sales tax audit? If asked, do customers know whether the COVID-19 surcharge is subject to sales tax? Do owners know if the COVID-19 surcharge is subject to tax? Even if they do, is their point-of-sale terminal properly programmed to charge sales tax at the correct rate on the surcharge before generating receipts? Based on businesses that have come to BPM with their sales tax issues over the years, most owners probably do not know if they should be charging sales tax on the COVID-19 surcharge. After all, sales tax laws do not clearly state: "Sales tax should be charged on all COVID-19 surcharges."

So, should a business be charging sales tax on the COVID-19 surcharge? It may sound ridiculous to some, but in many tax jurisdictions, the answer is a clear yes. Sales tax must be charged on the purchase price for items subject to sales tax. In most states, a COVID-19 charge separately stated at the end of a receipt is still part of the taxable purchase price, because it is a mandatory charge and not an optional add-on, as a tip at a restaurant is. Mandatory generally means subject to tax, whether it is separately listed or not on the buyer's receipt. However, if the purchased item is a service that is not taxable or is an item that is non-taxable, like groceries purchased in California, a COVID-19 charge at the end of a receipt is not subject to tax, because sales tax does not have to be charged on the purchased item.

As mentioned earlier, listing the COVID-19 surcharge toward the end of a receipt could be a red flag for a sales tax audit. Sales tax authorities searching for businesses to audit can openly see the correct amount of tax is not being charged and a quick cost/benefit analysis could green light the business for an audit. Restaurant, bar and business owners just trying to survive in today's world can ill-afford having to devote resources to a sales tax audit on top of struggling to keep the doors open.

Restaurant and bar owners who have undergone sales tax audits in their past will likely tell you a tax assessment may very well be forthcoming when chosen for an audit because a large percentage of their sales receipts are in cash. Verifying all cash receipts are reported on the restaurant or bar owner's tax return may be difficult to prove to a skeptical auditor. Unfortunately for these business owners, rightly or wrongly, their businesses also have a reputation with sales tax auditors of not reporting all of their taxable cash receipts.

As an example, sales tax auditors know bartenders can innocently make cash sales, yet when times get busy, they forget to run the cash sales through their registers correctly. Even the most valiant efforts by restaurant owners and bar operators to report 100 percent of cash sales may not be enough to avoid audit assessments, when an auditor uncovers some circumstantial evidence in the taxpayer's operations that not all cash sales have been reported.

Although previously unseen, you can presume it is also possible that online retailers may want to be creative like restaurants and try to add a COVID-19 surcharge to the end of their sales receipts. So long as it is fully disclosed to the online buyer prior to clicking on the purchase button, such charges may be perfectly legal, depending on the state laws where the buyers and seller are located.

Online sellers who want to include a COVID-19 fee may have the added advantage over restaurants and brick-and-mortar stores because they may have the ability in their checkout process to ask the buyer if they are willing to pay the surcharge. For buyers who do not wish to pay for whatever reason, the COVID-19 surcharge would not be added to the amount charged to the buyer's credit card at checkout time. This process has the added benefit of not having to collect sales tax on the charge, because now it is

---

paid voluntarily by the buyer and is not mandatory to make the requested purchase. Voluntarily paying means the surcharge is more like the voluntary tip at a restaurant that is not subject to sales tax.

Creativity aside, but knowing the downside of a COVID-19 surcharge, sellers may be better off just raising their prices to get the additional revenue they seek. The public relations nightmare created by a COVID-19 fee might not be worth the net revenue generated in the end.