

## MITIGATING RISK THROUGH SALES TAX MANAGEMENT

Ever stay up nights worried about a risky deal? In sales, every deal carries risk and as the initiator of the deal, you try to mitigate your risk as much as possible. We are all familiar with the credit application process required to close most deals whether it's a business loan or lease, a mortgage, car payment or merchant processing. The credit approval process has two goals, to make sure the borrower is trustworthy and limit the lenders risk.

Beyond a credit check, lenders mitigate risk with insurance. They may require a borrower to carry additional insurance to guarantee a loan or simply require insurance with certain limits in case of a catastrophic event like a fire or slip and fall or my favorite, the "act of god" as in a flood or a lightning strike. Yes, insurance can mitigate risks, but what about the hidden uninsured and unknown risks lurking just below the surface that can quickly send a loan into default before a lender even knows about it? There is an axiom for measuring risk that says the longer a lender waits for a payment, the greater the risk. Some business models such as utility companies routinely build risk into their rates because they cannot repossess electricity once it is used. The longer the lender waits for the borrower's payment, the higher the risk and consequently the rate. (Illustrated below)

One of the greatest unknown risks and one that is rarely insured is the non-payment of taxes. If property, payroll or sales taxes go unpaid and become delinquent, lenders are often the last to find out and usually with dire consequences. Non-payment of property taxes can result in foreclosure while non-payment of payroll or sales tax and result in massive penalties, property liens or even an owner going to jail. Mitigating these risks should be a priority to any lender, but is often overlooked.

There are solutions available to lenders to help mitigate these risks. For instance, non-payment of property tax is somewhat mitigated by including then in a business's lease or mortgage payment to be managed by a third party. Payroll taxes can be outsourced to any number of payroll companies who efficiently collect payroll taxes each pay period and file and remit on the merchant's behalf.

That leaves sales tax which is widely misunderstood by lenders and the one tax that exposes them to the most risk. Businesses are legally obligated to collect sales tax and it is often mismanaged by merchants. Sales tax is collected as part of a business's sales and everyday their revenue including sales tax is deposited into their business checking account as part of their daily card settlement and cash deposit. Once funds are deposited, sales tax and working capital are co-mingled making it hard to keep track of what's what. Having a bank account that is slightly inflated by a few thousand dollars of sales tax every month makes it easy, not to mention tempting to use this extra revenue to pay bills. But when the sales tax payment comes due to the State the next month, merchants struggle to come up with \$5,000 or \$6,000 dollars to pay it. Quite often this puts them between a rock and a hard place facing a decision to keep the lights on or pay sales tax. Most owners opt to keep the lights on and the doors open and naively worry about sales tax later. Doing so poses both legal and financial consequences. On the financial side, few owners realize that they are actually taking a short-term loan from the State and they fail to consider or calculate the true cost of borrowing sales tax revenue to fund their business. On the legal side, far worse than that, in some instances the State may consider this to be a criminal act!

Unfortunately in many cases like this, the saga doesn't end here. Instead this is the beginning of a very long uphill battle for the business to get back on track. Quite often a missed sales tax payment gets forgotten because it's out of sight out of mind and the next month rolls around and another \$4000 of sales tax is due making the two month total \$8800. The merchant's behavior doesn't change and sales tax continues to be used as working capital and the next payment is missed and the total of sales tax, penalties and interest due goes north of \$9600. It's easy to see where this is going because the business is only grossing about \$50,000/month and now 20% of their sales will go to paying back sales tax owed. Unless the business has revenue increasing exponentially, month over month the chances of catching up diminish quickly and the business is headed off a cliff.

Missing a sales tax payment deadline or making a short payment results in excessive fines and penalties that can easily devastate a business and leave a lender with a bad debt.

Approximately 20% of businesses in the US are behind on sales tax representing a huge unknown risk to lenders. A lender would only know a business is behind on sales tax if they research the State's monthly or quarterly delinquent taxpayer reports or if the State levies the merchant's bank account for back taxes. By this time it is probably too late to help the merchant and the loan is headed to default and assets are headed for auction. When the state closes a business for sales tax, they get their money first and everyone else gets in line to receive pennies on the dollar.

There is now a way for lenders to protect themselves and reduce the potential risks sales tax poses to near zero percent. DAVO Technologies has developed the DAVO Sales Tax app that removes the merchant from their obligation to manage sales tax. The DAVO app uses data from the merchant's POS or accounting system to automatically impound sales tax revenue collected by a merchant daily and then automatically files and pays the sales tax to the state on-time and in full. The merchant does not have to do anything; the entire process is seamless and automatic. DAVO does for sales tax, what ADP does for payroll.

DAVO removes the merchant from the sales tax process virtually eliminating the risk of non-payment of sales tax through mismanagement of sales tax funds. Making DAVO a part of a loan, credit line or lease deal can help a lender reduce the risk of non-payment of sales tax by a merchant to virtually 0%. DAVO shines a light in the dark corner of sales tax acting as an insurance policy making sure a borrower is sales tax compliant.

Find more information on DAVO Technologies and the DAVO Sales Tax App at [www.davotechnologies](http://www.davotechnologies) or [www.davosalestax](http://www.davosalestax).

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