



Bookkeeping 101: The Ceterus Way

How sales tax transactions make it into the books is a common question. Sales tax is complicated because the account is affected by sales activities and payments to the State (and in some cases local jurisdictions). Let's walk through the flow of transactions related to sales tax, which will help eliminate the mystery around sales tax.

Before we get into the walkthrough, we need to agree on one very important piece of information as it relates to sales tax transactions.

Sales tax collected is not revenue and sales tax paid is not an expense.

The above statement is true because the flow of sales tax transactions is simply a passthrough. The business is collecting a tax for the State and remitting it. The business is merely a middle man - collecting no fees for playing this role and incurring no expense either (you could argue the time it takes to submit payments is an expense, but we would be headed down a rabbit hole at that point).

Now that we have that out of the way, let's move on. I am going to borrow from other bookkeeping 101 information to help us walk through how sales tax works.

For most businesses, sales tax is collected every day and is entered into the point-of sale (POS) system. Because sales tax is not revenue and not an expense it is reflected on the balance sheet. When sales tax is collected, the sales tax payable account increases. When sales tax is paid to the State, the sales tax payable account decreases.

Below is a sample POS report (also used in Undeposited Funds chapter). This report reflects a single day of sales activity.

Service Sales - \$1,000	Product Sales - \$500
Tips Collected - \$200	Tax Collected - \$30
Payment Type: Cash - \$100	Payment Type: AMEX - \$700
Payment Type: Visa/Mastercard - \$930	Total Collected - \$1,730

This report shows that on this day, \$30 was collected from customers related to sales tax. We don't have a breakdown of how those payments were made (Visa, AMEX, Cash, etc). For simplicity sake, I am going to assume all sales tax was paid with a Visa credit card. Below is the journal entry that would be posted to accurately reflect the collection of sales tax for the day.

Account	Debit	Credit	Explanation
Undeposited Merchant Collections	30		Dollar value of sales tax collected, but not yet received in the operating account
Sales Tax Payable		30	Dollar value of sales tax collected that will be paid to the State on the next due date (generally monthly, but can be quarterly or less frequent)

When the next due date comes around, the business will remit payment to the State. For simplicity sake, let's assume that \$30 was the total collected for the month and therefore the amount due the following month. When payment is made, the journal entry to record the transaction would look like this:

Account	Debit	Credit	Explanation
Sales Tax Payable	30		Dollar value of sales tax collected last month paid to the State
Operating Account		30	Dollar value of payment to the State for sales tax

The sales tax payable account is simply a flow through account. In most cases, you should be able to easily track sales tax collections for the month and the payment made to the State in the following month. If you can't reconcile this account easily then you know there is something wrong and further investigation is required.