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New Sales Tax Requirements Require Contract Changes

Effective October 1, 2006, the New Jersey Sales and Use Tax will be expanded to now tax a number of things that were previously sales tax free. For example, included in this expanded list of items is "Information Services" and "Digital Property." Sellers of these items will now be required to remit a 7% sales tax to the state. (A complete list can be found on the New Jersey Division of Taxation web site at www.state.nj.us/treasury/taxation/salestaxbase.htm)

Sellers face two problems with this new tax.

1. Although the obligation to collect the tax begins on October 1, 2006, detailed guidance from the New Jersey Division of Taxation on exactly the types of information services that will be subject to the tax is not likely to be available until many months later.
2. Sellers with prior contracts that include the newly taxable goods and services to be rendered or sold after October 1, 2006, may not have included provisions in the contracts entitling the seller to pass on the new sales tax cost to the buyer. As a result, sellers may have to absorb the extra 7% cost for the remainder of the term of the contract. This may be very costly for sellers under long term contracts.

Here are some helpful tips for sellers in this predicament.

- Going forward sellers should include provisions in their new contracts that address sales tax requirement and pass the extra tax cost onto their customers. Even sellers of goods or services not currently subject to sales tax would be well advised to include such a provision in their contracts. Who knows how the law may change again in the future.
- Existing contracts should be reviewed to determine how to address the new tax. Is there an express provision stating that all prices are inclusive of sales taxes? Is the contract silent? Your approach to the situation (and your customer) may be different depending on what your contract says (or doesn't say).

If you are not sure whether the new sales tax applies to you, you are probably not alone. You will need to make some hard decisions about whether to effectively increase your price by 7% and collect the sales tax, just to be safe, or not collect it and risk liability.

In deciding whether to collect sales tax, you should review your existing agreements for provisions which require that any sales tax be identified as a separate line item on the invoice. Under these provisions, if you don't collect the tax at the time of sale, you generally lose the right to go back and require payment of it later. If your contracts includes these types of provisions, it may influence your decision as to whether to collect the sales tax. If you do not have these provisions, you still may elect not to collect the sales tax, but consider putting your customer on notice that you may retroactively be required to collect it at a later time.

This information is not to be construed as legal advice. If you have any questions regarding the new sales tax requirements for information services and digital property, or if you would like to discuss any other intellectual property issue, please do not hesitate to contact GH&C Shareholder Kurt E. Anderson at kanderson@ghclaw.com or 732-741-3900.

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