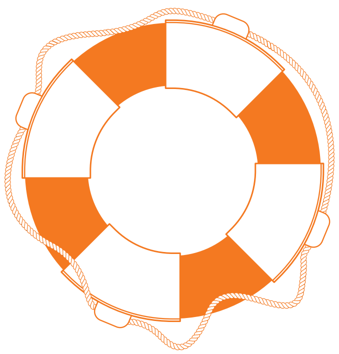
Sales Tax Survival Guide 2017

Avalara



Welcome to the 2017 edition of Avalara's annual Sales Tax Survival Guide. Sales tax challenges are constantly evolving. This year's revised and updated guide gives tips to help your company survive 2017's biggest sales and use tax compliance issues.

This guide is not to be used as a substitute for professional tax advice. Consider it a tool to help you understand and prioritize your sales and use tax challenges for 2017 and beyond.

States budget deficits drive change in 2017

When state budgets get tight, tax law enforcement gets tighter. In the 45 states that collect sales tax, businesses with a connection to the state (called nexus) are obligated to register and remit the correct amount of sales tax. Once considered difficult to reach by state taxing authorities, out-of-state firms and small sellers are no longer immune as states expand rules around nexus, hire auditors and file qui tam lawsuits to try and recoup losses from remote sales and recover from budget shortfalls. With the complexity and constant changes made to state sales tax rates and regulations, many businesses that may not even realize they are out of compliance. But that doesn't protect them against audits, penalties or fees if they're found to be in violation of the law.

In 2017, it's not enough for a business to be aware of its sales tax obligations. You need to be fully prepared to comply with them. That means employing best practices for managing sales and use tax compliance and the laws change – and as your business changes – and knowing what solutions are available to make the job easier and error-proof. That's why, for each sales tax challenge in our 2017 guide, we're presenting survival tips to get you on the path to compliance.

Sales Tax Survival Challenge #1: Determine nexus

One of the easiest ways to end up with unexpected tax liability is to ignore nexus. Defined as a substantial connection between your business and a state, nexus regulations determine whether you are required to file and remit taxes to a given jurisdiction. Understanding nexus is crucial to getting compliance right as your business expands.

Survival Tip: ***Learn more about what can trigger nexus.***

Many businesses are surprised to learn that nexus connections can be made through relatively innocuous or seemingly casual business activities. Having a remote employee in another state, using warehouse space in another state through a program like Fulfillment by Amazon (FBA), or even attending trade shows in another state can all trigger nexus in some states. If you are not sure whether you've properly identified nexus obligations for your business, this brief questionnaire can walk you through some of the most common issues. On a state-by-state level, department of revenue websites usually include a page discussing what triggers sales tax nexus within the state.

Survival Tip: *Understand click-through and affiliate nexus.*

One of the most rapidly-changing areas of sales tax compliance is "click-through" or "affiliate" nexus. In order to collect sales tax revenue on previously untaxable sales (typically online sales) some states have declared affiliate relationships to create nexus. This means that if someone in another state provides promotional codes or affiliate links that help your business make sales, you could be creating nexus in that state. Under these thresholds, even small businesses can find themselves with nexus in states they never anticipated paying sales tax in. Don't be caught off-guard by these new laws. Read up on which states adopted these protocols in this guide to click-through sales tax nexus.

Survival Tip: *Keep an eye on economic nexus*

The definition of nexus has expanded a great deal in just the last two decades in the absence of federal ecommerce legislation. Internet sales tax bills have repeatedly been proposed in Congress but so far none of them have been adopted into law. That doesn't mean online sellers are off the hook for sales tax, however. It only means states are tired of waiting and are taking matters into their own hands. This includes attempts to overturn Quill v. North Dakota by some states including Alabama, Florida, Colorado and North Dakota as well as a growing number of states introducing economic nexus (a connection to a state based solely on sales revenue or volumes of sales into a state). It's likely that states will continue to push the nexus and businesses should be both aware and prepared to deal with these new requirements.

Sales Tax Survival Challenge #2: Keep up with laws and regulations

As states seek new revenue streams, they change the rules: rules about which products and services are taxable or exempt, who pays taxes, when sales and use taxes are filed, and tax rates. Thousands of these tax rule changes happen every year, making it tough to maintain compliance.

Survival Tactic: *Get acquainted with DoR websites*

Each state's department of revenue has its own website, where new rules (and, often, clarifications of existing rules) are published along with forms and filing deadlines. To keep up with rule and regulation changes in the states that matter to your business, you'll want to familiarize yourself with the layout of these sites and the resources available on each. Since each state's department is independent from all other state departments of revenue, these websites look and feel drastically different. Spend some time exploring each one, and you'll be better equipped to find any new tax information you need to know.

Survival Tip: *Stay informed on what's new or changing*

Trying to keep up with every change to sales and use tax laws and regulations would be an arduous process. Thank goodness there are free online resources that do that work for you including Taxrates.com and Avalara.com. From recent tax rate changes to discussion of federal internet sales tax reform proposals, you'll find insightful, timely information, blogs, articles, reports and expert commentary that you can access to help keep you up to date on tax issues relevant to your business.

Survival Tip: *Automate taxability and rate determination*

Keeping up with new sales and use tax laws gets tougher as the number of states your business collects taxes for increases. If you're feeling swamped by the sheer volume of tax law changes, offloading your taxability and rate determinations to tax automation software like Avalara AvaTax can reduce this burden, allowing your company to focus more on revenue generation and less on avoiding audit risk. Avalara's rate accuracy guarantee means that you don't need to worry about rate discrepancies costing your company money in the event of an audit.

Sales Tax Survival Challenge #3: File returns on time

If every sales tax jurisdiction used the same schedule for filing returns, businesses would have an easy time avoiding late filing fees and penalties. Unfortunately, every jurisdiction is different: some require annual filing, some quarterly, some monthly – and some have different requirements for different types or sizes of businesses, or different due dates for paper filers and electronic filers. Avalara's states and dates guide is a helpful reference for keeping track of schedules, deadlines and filing requirements for every state.

Survival Tip: *Know your jurisdiction rules*

Filing on time, every time means knowing the due dates for every jurisdiction in which you have nexus. In some states with local "home rule" jurisdictions, this may require knowing due dates not only for the state but also for local jurisdictions. Check state department of revenue websites to confirm the exact details of this year's due dates. Avalara's guide to solving filing and remittance problems can help you understand more of the specific details that may impact when your returns are due.

Survival Tip: *Learn about amnesty programs*

If you've failed to remit the proper amount of sales tax or have gotten behind on filing, many states offer temporary amnesty programs to allow a penalty-free late remittance period. Requirements to take advantage of amnesty programs can vary significantly, and other states offer "voluntary disclosure" programs that act in a similar way. Avalara's professional services can help businesses evaluate whether it makes economic sense to use an amnesty or voluntary disclosure program in the event of late or missed sales tax payments.

Survival Tip: *Streamline the returns process*

Filing one sales tax return can be time-consuming. Filing dozens is a massive headache. Streamlining the returns process is just good business sense, but different solutions make sense for different businesses. Small businesses or mid-size companies that only need to register, remit and file returns in a few states may opt for an easy, signature-ready online forms remittance service like TrustFile. Companies with more complex needs can fully automate the returns process, which makes it as easy as reviewing a multi-state ledger, approving the total, and clicking a button to file and remit all taxes at once.

Sales Tax Survival Challenge #4: Manage exempt sales

When a purchaser is exempt from paying sales tax, whether that purchaser is the federal government, a non-profit organization or a wholesaler, a sales tax exemption certificate must be received and filed. While many businesses try to maintain these files physically, manual filing leaves you open to audit risk and errors. If exemption certificates are integral to your tax compliance practices, check out our exemption certificate survival guide for additional information.

Survival Tip: *Verify and validate exemption certificates*

When you receive any new exemption certificate, make sure the certificate is valid and that all certificate numbers are correct. It's important to verify each certificate with each jurisdiction's taxing authority (for example, California's verification system for exemption certificates can be found here). Businesses that fail to verify certificates are cutting a corner that could lead to more risk. Taking on this task manually can be cumbersome and prone to errors or oversights. Automatic verification can ensure that any discrepancies are caught long before they become a problem.

Survival Tip: *Keep certificates up to date*

Sales tax exemption certificates aren't valid forever. When businesses obtain these certificates to sell to tax-exempt customers, they sometimes forget to note the expiration date of the certificate and flag it for renewal. Having an expired certificate, in the eyes of the auditor, isn't any better than not having one at all. If you're handling exemption certificates manually, it is critical to maintain a record of expiration dates and either contact your customers to obtain an updated certificate, or ask them to provide one the first time they make a purchase after the expiration of their existing certificate. Otherwise, you could find yourself falling out of compliance, one customer at a time.

Survival Tip: ***Ditch the filing cabinets***

One of the easiest ways to lose or misfile exemption certificates is storing them only as physical, hard copies. Filing cabinets are prone to misfiling and make for difficult, time-consuming searches. At audit time, paper records take longer for auditors to sort through, leading to longer, more expensive audits. Scanning your exemption certificates is a good first step toward maintaining digital records. Using an automated solution like Avalara CertCapture allows you to make that step far more powerful, allowing for automated verification and document management. Automation ensures lower risk at audit time and significantly reduces the time auditors take to comb through exemption certificate records.

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Sales Tax Survival Challenge #5: Exemption certificate management

Finding the right state tax rates is the easy part of getting sales tax right. Then the tricky parts start: learning which states allow different rates in different jurisdictions, then figuring out which rates from which jurisdictions properly apply to each transaction.

Survival Tip: ***Learn your sourcing rules***

Sourcing refers to the location where a sales transaction is taxed. Some states tax sales based on origin – where the seller is located; others base sales tax on destination – the location where the buyer takes possession of the item sold. As a seller, it is important to know whether you are located in an origin-sourced state or a destination-sourced state. To complicate matters, sourcing rules work differently if you are a remote seller, meaning you are based in one state and are selling into another state where you have nexus (an obligation to collect sales tax). More on sourcing rules.

Survival Tip: ***Get past the ZIP code***

Many businesses still get tax rates by looking up a table with ZIP codes and an associated rate. If ZIP codes and tax jurisdictions always lined up, this wouldn't create the possibility of errors. Unfortunately, ZIP codes are a convenience for the federal postal service, while tax jurisdictions are created by state and local authorities. Translation: the boundaries have nothing to do with one another. In states like Colorado, tax district borders are so tangled that next-door neighbors can have different sales tax rates. Geolocation is a much more reliable and accurate tool for calculating exact sales tax. Geolocation technology is built into Avalara's tax calculation software so that the exact right tax rate is automatically applied to every transaction. The advantages of geolocation over ZIP codes are well illustrated in this whiteboard video.

Survival Tip: ***Know your Home Rule states***

Some states make a single statewide taxing authority the source for all tax rules and regulations, as well as the sole determiner of nexus in the state. However, other states allow local jurisdictions to have some level of control over sales tax. Depending on the state and the extent of its "home rule" doctrine for local tax districts, different challenges can arise. In some states, nexus must be established in a local jurisdiction in order for local sales taxes to be collected – while in others, simply having nexus anywhere in the state creates a nexus obligation for all taxing jurisdictions within the state. This Q&A can give more insight into the complexities of home rule.

Sales Tax Survival Challenge #6: Understand drop shipping tax relationships

Drop shipping arrangements allow sellers to simplify order logistics and expedite delivery to customers, but it can also complicate sales tax. Drop shipping involves two types of transactions: one between the seller and the buyer and one between the seller and a third party supplier who delivers the product directly to the customer on behalf of the seller. Both can get tricky when it comes to sales tax. This guide provides more information on understanding the tax implications of drop shipping.

Survival Tip: ***Stay on top of nexus laws***

Retailers rely on drop shippers to help them get product into customers hands faster, usually by having inventory shipped directly from a manufacturer or wholesaler. As a seller, you are generally only obligated to collect sales taxes on a sale if you have nexus in the customer's state. However, in some states, use of an in-state drop shipper by an out-of-state retailer is considered a nexus-creating relationship. In California, New York, Texas and Florida, for example, if a drop shipper delivers goods on a remote seller's behalf, that seller could be obligated to collect sales tax on the taxable sale even if the seller doesn't have nexus in the ship-to state. Furthermore, certain states, including California, Connecticut and Hawaii, will obligate the supplier (or drop shipper) to collect sales tax if they have nexus in that state but the seller doesn't. Read more on the topic of drop shipping and nexus.

Survival Tip: *Know state rules for reseller certificates*

Most states don't consider the transaction between the retailer and the drop shipper a taxable transaction as long as proper documentation (a valid resale or exemption certificate) is provided. Resale exemption certificate procedures are individual to each state. Many states will accept an out-of-state resale certificate, multijurisdictional form or alternate documentation in a drop-shipping situation. However, in the states that don't accept these, the seller may have to deal with some unexpected requirements. For example, in California and other states that have stricter requirements for resale certificates, a seller may have to register with the state in order to provide a valid exemption certificate. By registering in order to get that certificate, the seller would now be obligated to collect sales taxes from customers in that state even though the seller previously did not have nexus. For more scenarios involving exemptions, check out our drop shipping Q&A forum.

Survival Tip: *Keep tabs on Amazon*

Fulfillment by Amazon (FBA) is a popular and profitable drop shipping program, providing ecommerce sellers with an expansive infrastructure for order fulfillment. Beginning March 1, 2017, Amazon will collect sales tax in 36 states, including Iowa, Louisiana and Utah, where the company does not have nexus but is collecting and remitting sales tax. Why the voluntary paying of sales tax? It's possible that Amazon is anticipating federal remote seller sales tax legislation will be enacted, or perhaps the company has plans to open warehouses or distribution centers in those states. Sellers who participate in FBA or plan to expand their online sales should consider following Amazon's lead and getting ahead of any sales tax obligations that could arise from drop shipping relationships.

Sales Tax Survival Challenge #7: Get service taxability right

Sales and use tax used to apply exclusively to sales of tangible personal property (TPP). When the economy of the United States shifted from manufacturing-driven to service-driven, services began to be taxed as well. Today, most states that charge sales tax consider at least some services taxable.

Survival Tip: *Know if your state is "presumed taxable"*

Most states that charge a statewide sales tax include some services. Each of the states that charges taxes on services can be considered either a "presumed exempt" or a "presumed taxable" state. Most states are "presumed exempt;" that is, a service is considered exempt from sales tax unless specifically made taxable by law. In four states, however – Hawaii, New Mexico, South Dakota, and West Virginia – services are "presumed taxable." In other words, in these states, a service is considered subject to sales tax unless a specific exemption has been made. If your business is engaged in selling services, it is important to know which states make a presumption of taxability. Learn more about sales tax on services.

Survival Tip: *Beware of bundling*

In many states, service charges are considered taxable when they cannot be separated from the sale of tangible personal property. This means that if you sold a dishwasher with "free" included installation, versus selling the dishwasher for $50 less but with a $50 installation fee, a customer would have to pay more in sales taxes. Because of this, depending on your sales tax jurisdiction and how it handles bundled purchases of services and TPP, you may want to create separate service charges. This difference can ensure that you're saving your customers from paying taxes on services that would otherwise have been exempt.

Survival Tip: *Watch for new laws*

Because cash-strapped states are seeking new sources of revenue, service taxability is expanding in many jurisdictions. Even if your business is currently not subject to sales and use tax, or only a small portion of your sales are taxable, expansion to a new state or changing laws and regulations could make your taxability picture more complex. Monitoring news sources and blogs, as well as state department of revenue websites, can help you to keep abreast of any new developments that could affect service taxability for your business.

Sales Tax Survival Challenge #8: Register to collect tax

Before you can file and remit taxes to any jurisdiction, your business needs to file registration forms. These forms vary depending on jurisdiction. While some states require just one registration form to collect tax in the entire state, many local jurisdictions in home rule states have their own individual registration requirements.

Survival Tip: *Know what triggers registration requirements*

Generally, if you are making any taxable sales in a state, the state will require you to file for a sales tax ID number. Many states (like New York) base registration requirements on what specific goods or services are being sold, and do not require businesses to register if none of these sales are likely to be taxable.

Survival Tip: *Learn your NAICS code*

In order to register to remit sales tax, you will need to know the NAICS code that describes your industry. This code will be required on most state registration forms. If you need to look up your industry's code, the NAICS website has a handy lookup tool. For example, one commonly used NAICS code is for internet retail sales: 454111. All internet retailers, regardless of the specific goods they sell, will register using the same code.

Survival Tip: *Outsource registration form filing*

When your business is growing, you don't want to take a chance on getting registration wrong. Instead of filing registration forms yourself, consider putting that time and effort back into your core business functions while outsourcing the tedious tasks associated with registration. Outsourcing can also help if you're interested in deregistering from a state. If you no longer have nexus, deregistration can ensure that you are no longer on the hook for filing taxes in a state. Avalara Professional Services offers a full range of registration and deregistration services for businesses with outsourcing needs.

Sales Tax Survival Challenge #9: Don't forget about use tax

So you've tackled sales tax, but what about its less-understood cousin, use tax? Two types of use tax, sellers' use tax and consumer use tax, can pose compliance issues for businesses in the United States. To avoid running afoul of auditors, you'll need to familiarize yourself with both. You can get a head start by reviewing what's the use of use tax?

Survival Tip: *Get the rates right*

Even if you're sure about the sales tax rates in the jurisdictions where you collect and remit sales tax, make sure that you also confirm the proper use tax rates. Many businesses are surprised to learn that use tax rates and sales tax rates are not always equivalent. This discrepancy can lead to compliance issues and makes use tax a prime target for state auditors. In fact, 80 percent of audits are for use tax, while only 20 percent are for sales tax. And at least five states, including Colorado, South Dakota, Louisiana, Oklahoma, and Kentucky, have adopted use tax reporting requirements for out of state sellers.

Survival Tip: *Understand both use tax types*

The names of the different use tax types can be confusing. Some sellers think that they are only liable for paying the sellers' use tax and that only individual consumers are responsible for consumer use tax. The truth is that any time your business paid no sales tax (or a lower sales tax rate than your state charges) for products you used in the course of business, you will be liable for consumer use tax. That means if you're buying printer toner online, or making other purchases from out-of-state sellers who do not charge sales tax, you need to pay the proper use tax rate to avoid falling out of compliance. Check out this short video to learn more about getting consumer use tax right.

Survival Tip: *Know your use tax exemptions*

While most purchases used in a place of business will be subject to consumer use tax, many states make exemptions for certain types of purchases. One of the most common of these exemptions is manufacturing equipment; typically, use tax is not due on equipment used to manufacture other goods. Some companies overpay use tax or keep large amounts of money in reserve for potential tax issues. This can be avoided by understanding and using the exemptions available. Tracking changes to these exemptions, however, can be difficult without automating sales and use tax compliance – especially when a business operates in a number of different tax jurisdictions.

Sales Tax Survival Challenge #10: Survive audits and lawsuits

If you've never been through a sales tax audit before, it can be a daunting prospect. The average audit typically lasts 30 to 45 days and auditors can be on-site for two to four weeks. Being able to prove that you have collected and remitted the right amount of tax is critical to the process. Yet a recent Wakefield Research study found that more than 50 percent of companies surveyed believe that an auditor would find errors if their company was subject to a sales tax audit. Tax automation reduces that angst. Avalara customers spend 79 percent less time proving compliance during an audit and get the added benefit of an audit accuracy guarantee.

Survival Tip: *Collect and remit correctly*

The single best defense any business has against an audit or qui tam lawsuit is getting rates and product taxability right. Even the most meticulous record-keeping won't protect your business from fines and penalties if customers have been charged incorrect rates or you have been remitting less to the state than you've been collecting. Getting this complex step right can take a lot of effort – especially if you sell a wide variety of products. Check out a video on how sales taxes on food can be a minefield for sellers, and learn more about automating product taxability with Avalara.

Survival Tip: *Keep documentation organized*

If you're filing documents manually and showing your auditor stacks of paper, it's likely that you'll be in for a long slog. Missing or expired exemption certificates are a particularly pesky problem, as many businesses don't realize that they're required to keep these certificates ready for auditors to look at. Bottom line: If you can't produce the certificate, you will be assessed. Companies historically have not been successful in winning a legal argument on an audit assessment if there was a lack of proper documentation. Documentation management software can be a big help in ensuring a clean audit trail.

Survival Tip: *Understand the audit process*

If your business receives an audit notice, it's important to know enough about the audit process to prepare adequately. These tips from former auditors can help you get ahead of the game in case you are audited in 2017 with advice for what to do – and what not to do. You may also consider whether you need to bring in outside help to make your audit run more smoothly. The big takeaway? If you make things easy on your auditor, you'll make things easier on yourself. If your records and processes are in good order, you don't have anything to fear from an audit. Automating the document storage and retrieval process helps. Avalara customers have even seen auditors "run out of things to look for" in their first day of the audit.

Your Life Ring: Automate sales and use tax

Managing transactional tax can be overwhelming, especially if you are obligated to register, collect and report sales and use tax in several states. It is survival mode just trying to keep up with different rates, rules, and regulations. You're on the hook to get it done and held liable by states (and state auditors) if it isn't done right. Automating sales and use tax compliance in your accounting system, ERP or ecommerce system can alleviate much of this strain and put you on a more even keel. Avalara's tax management software ensures accurate tax calculation, proper management of tax exemptions, and streamlines the remittance and filing process for sales tax returns in every U.S. jurisdiction. Make 2017 the year you rescue yourself from the hassles of sales tax and sail through compliance with ease, confidence and Avalara sales tax automation software.

About Avalara

Avalara, Inc., is a leading provider of cloud-based tax automation for businesses of all sizes. We help businesses achieve transactional tax compliance for sales and use, excise, communications, VAT and other tax types. Avalara's comprehensive, cloud-based solutions are fast, accurate, and easy to use with more than 500 hundred pre-built connectors into leading accounting, ERP, ecommerce and other business applications. Our Compliance Cloud™ platform helps customers manage complicated and burdensome tax compliance obligations imposed by state, local, and other taxing authorities throughout the world. Each year, Avalara processes billions of indirect tax transactions for customers and users, files hundreds of thousands of tax compliance documents and tax returns, and manages millions of exemption certificates and other compliance related documents.