Evolving for Growth

Creating tax compliance strategies for new products and sales channels

Avalara

In its first years doing business, direct selling cosmetics powerhouse Avon consisted of one man selling books door-to-door. Toy giant Hasbro got its start selling textile remnants and, later, school supplies. The Marriott hotel empire grew from a single Washington, DC root beer stand into a lodging and hospitality powerhouse, while Samsung evolved from a noodle exporter into one of the world's leading electronics manufacturers.
Change is a natural part of growth for smart businesses. But venturing into new sales channels and selling new products can have unintended consequences – and may even put your tax compliance efforts in jeopardy. While sales and use tax may not be top-of-mind when adding products and sales channels, compliance failures present a significant source of risk for growing companies. This paper explores how shifting products and sales channels can impact tax compliance – as well as best practices to successfully navigate these changes while minimizing risk.

Product Taxability

Venturing into new product categories can create major opportunities, whether your business is new or well-established. Odds are, sales taxability isn't your first thought when adding products, but it needs to be on your mind to avoid facing audit risk.

For example, let's say your company sells electronic devices online and through brick-and-mortar stores. After a few years of successful growth, you decide to start offering extended warranties to your customers. California customers won't be subject to tax on the extended warranties, but Washington customers will – and while they may be exempt from extended warranty sales tax in Wyoming, they won't be unless the warranty is purchased separately from the device itself.

With different taxability rules in different states and local tax districts, tracking taxability changes can get tough. Sellers of food products often find that even small changes to a product lineup – or even the ingredients in a particular recipe – can impact taxability. Adding flour to the recipe for a dessert bar changes it from a taxable candy to a tax-exempt food product in states like New Jersey.

For sellers of digital goods, the taxability landscape is even more challenging. Software companies will find that their digital downloads are taxed differently from sales of physical discs containing software, and that taxability can differ for custom-built and pre-built software.

Online and Offline Expansion

Sometimes, how you sell can create even more sales tax challenges than what you sell. When your growth plan includes incorporating new sales channels, it's imperative to understand the impact your new strategies may have on tax compliance.

One of the most common situations for businesses today: starting online sales. If your business has previously sold products at physical locations, it's likely that your tax compliance strategy involved staying up-to-date with rule changes only in the states and local tax districts where your retail stores were located. Once you start selling online, depending on whether your connection with other states is strong enough to require you to collect tax on remote sales (nexus), you may have to collect and remit tax in hundreds – or thousands – of different jurisdictions.

For some ecommerce retailers, the final growth frontier is that most old-fashioned of sales channels: a brick-and-mortar store. Online clothing retailer Mod Cloth, for example, just open its first physical location in Austin in late 2016. A slew of sales tax complications awaits: from the headache of appropriately refunding sales tax on returns of online purchases made in-store, to integrating information from point-of-sale systems and ecommerce software.

Shipping, Franchising, and Trade Shows

Millions of businesses have already started using Fulfillment By Amazon (FBA) to simplify complex sales and distribution challenges. However, because FBA works as a drop shipping program, using warehouse space in several locations to make distribution faster, using FBA can generate nexus in multiple states.
For a seller who previously had nexus in just one state, this adds a potentially difficult layer of bureaucratic requirements to sales tax registration, calculation, and filing. Keeping up with changes to sales tax rates and taxability of each product you sell becomes exponentially more difficult as nexus is established in more jurisdictions.

[1] Deloitte

Franchising is a great way to expand many businesses, but nexus can get complicated for both franchisors and franchisees – and so can exemption certificates, which need to be kept to prove that any non-retail transactions were correctly registered as tax-exempt.

For many businesses, trade show attendance is one of the best ways to rapidly expand a customer base and establish a brand. Many companies are totally unaware that in some states, like New York, selling a few products at a trade show could be enough to establish nexus – and an obligation to collect sales tax on all transactions to New Yorkers, even on purchases made over the phone or online.

Making a nexus mistake, even a seemingly small one, can be incredibly costly. The average sales and use tax audit costs over $100,000, according to a study conducted by Wakefield Research. Once mistakes are found, companies can expect more audits coming in a regular cycle, often looking over several years of past transactions (called the "lookback period") to investigate irregularities.

Just because auditors aren't knocking at a company's door doesn't mean the business is in the clear for sales tax enforcement. In some states, qui tam laws allow ordinary citizens, even those with no connection to the purchase of a product, to whistleblow on companies that have not registered for or paid sales tax. Recent cases raised by whistleblower attorneys in New York and Illinois have cost businesses big: in one case, a pillow manufacturer who didn't realize trade show attendance established nexus was forced to pay over a million dollars to settle a suit under New York's False Claims Act.

The right way to address nexus isn't to bury your head in the sand and hope it goes away – it's to conduct a nexus survey regularly, ensuring that you're collecting and remitting tax in every jurisdiction where you've established nexus. Once you address the sales tax issues created by establishing nexus in new states, you could see any of these nexus generation activities as a net positive. After all, once you have nexus in a state, you can't generate more nexus in that state by engaging in additional nexus-generating activities. So go wild – hire remote employees in the state, become a trade show vendor, or look into opening a physical location, all without fear of piling on more red tape from the taxman.

[2] Accenture

Automation: Enabling Growth Without Growing Pains

No company wants to put a damper on its own growth because of fears about tax penalties and bureaucratic requirements. But every form of growth – even dipping a toe into a new sales channel – can result in additional compliance complexities.

Trying to scale up manual solutions to take exponentially-growing complexities into account is a losing battle. When companies try to keep using the same sales tax strategies that worked in earlier stages of growth, the result is spending more and more time on compliance efforts that are less and less effective.

For true scalability, there's only one real solution: automation. When you automate the sales tax process from end to end, growth – of either your product lines or your sales strategies – stops wrapping you up in red tape.

Avalara's cloud-based software-as-a-service (SaaS) solution is updated continuously to keep track of every sales tax rule change in the United States. End-to-end automation integrates into the software you already use, powering up your financial, ERP, ecommerce, and point of sale systems with automated rate calculation, push-button returns filing and payments, reporting, and document management that keeps you protected in the event of an audit.

For more information on how automation with Avalara can make your path to growth easier, visit avalara.com.