5 Sales and Use Tax Tips (2016)

If sales tax compliance isn't a priority for your company in 2016, you could face risks that jeopardize the growth and future of your business. Compliance challenges, both large and small, can quickly spiral into serious and expensive problems if you're not careful.

These 5 tips provide a roadmap for sales tax compliance in 2016:

1. Watch for broader definitions of nexus.

Every time your company introduces a new product or service, sells into a new market location, or online into a state, remote seller nexus may apply. In 2016 these rules are a moving target. Due to state and federal court inaction, states have assumed a presumptive authority to broaden definitions of nexus, obligating more out-of-state sellers to collect sales tax.

Affiliate relationships are not only considered taxable when they occur among online sellers. Another affiliate relationship that creates a tax obligation is drop shipping. Drop shipping–shipping from the manufacturer or distributor straight to the customer–is another complex element of sales tax management. In some cases, the use of a drop shipper, or a contract with a distributor that functions as a drop shipper, is considered a taxable nexus-creating activity.

What states are doing:

Alabama:
Enacted a law January 1st, 2016 that broadly expands nexus to include all businesses with a "substantial economic presence," rather than only those with some physical presence in the state. This law is likely to be challenged on constitutional grounds, but if it survives, other states may soon follow suit.

Michigan:
Passed "click-through" nexus laws last year that require sales tax remittance from businesses generating click-through sales through affiliate links.

2. Track your product taxability exposure.

The variability of product taxability rules among states is likely to continue in 2016, especially around emerging technologies. In many states, product taxability and the sales tax rate depend on the type of product, sometimes its ingredients, the date it was sold, how it will be used, and the location in which it was purchased. To make matters worse, the traditional definition of what makes something a product (i.e., tangible personal property) is changing. Nowhere is this more obvious than in the treatment of developing technologies. With the rise of digital downloads, including music and movies, some states are broadening taxable product definitions to include virtual products.

What states are doing:

Maine:
Expanded definition of taxable food items to include a wide variety of snack and ready-made products. Precooked sandwiches, powdered drink mixes, and confectionery spreads like Marshmallow Fluff are among the items now subject to the state's 5.5% sales tax. Bakery goods are now also taxable, unless purchased in quantities of six or more.

California and Virginia:
Both states are currently considering bills that would remove sales tax from sales of feminine hygiene products like tampons and pads. Currently, only five states specifically exempt feminine hygiene supplies from sales tax laws, and women's groups have recently lobbied to see exemptions spread to more states.

Nebraska:
Legislators are currently considering a bill, backed by many large companies in the state, that would exempt custom software from sales tax. Under the proposed law, mass-produced software would still be considered taxable.

3. Pay attention to what services are taxable in what state.

States approach service taxability in various ways. Whether or not the service you provide is taxable depends on many factors including the customer's location, the location of your service, and whether or not the service fits into the broad service categories used by a particular state. Services that are typically considered taxable range from personal services to fabrication, repair, and installation.

Whereas states like Delaware, Hawaii, and Washington typically tax services, other states such as Virginia, and New Hampshire tax very few. For example, if you provide service contracts to customers who purchase your computer software, that service would be considered taxable in states like Florida. Services provided under the “professional service category” can be confusing given that the modes of service delivery are increasingly moving online. So-called cloud services, such as IT support offered remotely, can be considered taxable in some states.

What states are doing:

Ohio:
In December 2015, the Ohio Department of Taxation defined online advertising services, online lead generation, and online chat feature services as subject to sales tax. This contrasts with traditional advertising services – for instance, print advertising – which is still considered exempt from sales tax in the state.

North Carolina:
Starting in March 2016, North Carolina sales tax will apply to repair, maintenance and installation services for tangible personal property. In 2015, the state opted not to tax veterinary services and pet care, but legislators are still keeping an eye open for additional services to tax in order to better reflect the service-oriented direction of the state’s economy.

4. Keep accurate records of exempt transactions.

Sales tax exemption certificates enable a purchaser to make tax-free purchases that would otherwise be subject to sales tax. Resale certificates are provided to suppliers to substantiate that the items purchased are intended for resale only and therefore are exempt from sales tax. Sales can be exempt for many reasons including:

1. The nature of the use–how or where the goods will be used by the buyer (i.e., resale).
2 The nature of the goods or services sold–some states do not tax services and labor, others do.
3. The nature of the buyer–some states exempt nonprofits and government agencies from collecting sales tax. Others do not.

Collecting and filing these certificates can be a burdensome administrative chore, especially given the conflicting requirements of individual states. This is one of the most error-prone aspects of the sales tax management process that can leave a company at considerable risk in an audit due to expired or invalid certificates. In fact, disallowed exempt sales are a leading cause of audit fines, penalties, and interest.

What states are doing:

Alabama:

As of January 1, 2016, all businesses that are exempt from paying sales or use tax under Alabama law are required to obtain a certificate of exemption annually from the Alabama Department of Revenue. Annual reporting requirements also apply. Failure to file annual reports or obtain a certificate of exemption annually will result in businesses being unable to make tax-free purchases.

Minnesota:

Recently, Minnesota repealed a 1989 sales tax rebate law that required manufacturers to pay sales tax on purchases of capital equipment, then file for a rebate on each taxed sale. With the new changes to the law, manufacturers may simply provide a standard ST-3 certificate of exemption to suppliers in order to be exempted from paying sales tax on capital equipment at the point of sale.

5. Create a 2016 Action Plan.

Any sales tax compliance action plan for 2016 should include looking for more efficient, accurate, and cost-effective ways to manage the challenging sales tax environment. Companies striving to accurately collect, file, and report sales and use taxes face an uphill battle in 2016. Avoid practices that put you at risk for audit, such as using out-of-date rates and rules, failing to recognize new rules that create remote seller nexus, or using error-prone manual processes to manage unwieldy sales and use tax laws and rates.

Now what?

Managing sales tax compliance through technology automates the calculation, reporting, and remitting of use tax. Minimized human intervention reduces the risk of over or underpayment. Most software solutions also feature dynamic, on-demand tools that deliver reports quickly and easily, improving accuracy and discouraging audits. Companies also enjoy rapid ROI from technology solutions due to improved compliance and redeploying staff time to revenue-generating activities.

The costs of manual compliance are often higher than automating anyway. In their report, "Effective Sales and Use Tax Management: Reducing Errors and Increasing Productivity," the Aberdeen Group identified an alarming statistic–many financial officers underestimate the cost of sales and use tax compliance by 50 percent. These CFOs often assume sales tax compliance is handled due to the limited visibility of sales tax transactions and their lack of integration within manual billing and procurement processes. Given that the average penalty of a negative sales and use tax audit is $24,000 per occurrence, this assumption could bring ruin to many small- and medium-sized businesses.

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About Avalara

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