5 WAYS GROWING COMPANIES GET TRIPPED UP BY SALES TAX

WHITEPAPER

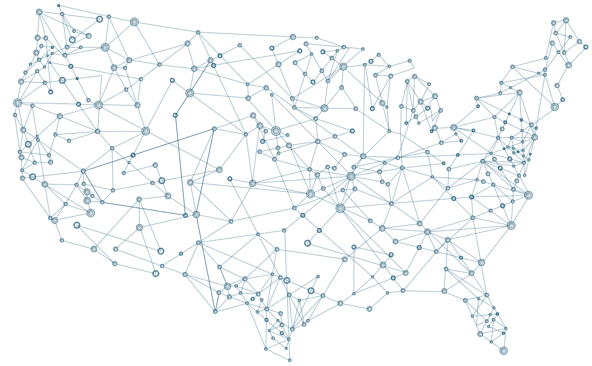
Avalara
Tax compliance done right

Some companies grow loudly, with splashy headlines and aggressive market trading. Others do it quietly, behind boardroom doors or on factory floors. But whether stock rooms or stock prices are driving growth, if your business is changing, your tax liability is likely changing too.

Nearly every industry has to deal with sales tax in some way, but high-growth companies can have it the hardest – and for good reason. Growth equals change. And with change comes new or different rules and regulations to follow – many of which may be unfamiliar territory to you.

Before the ecommerce boom, sales tax didn't make the headlines much or get a lot of attention from company executives. But the ever-increasing popularity of cloud, mobile, and online sales channels has shifted the tax landscape dramatically, incenting lawmakers to reinterpret the rules and forcing companies to comply.

All roads lead to nexus

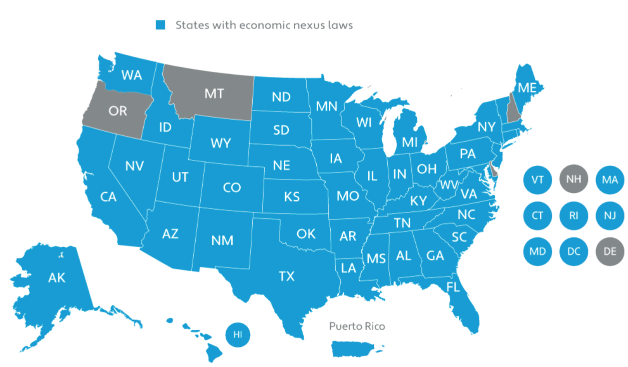


It's impossible to tackle sales tax compliance without first understanding nexus – a company's economic connection to a state based on qualifying sales activities.

Historically, nexus has been linked to a physical presence. In 1992, the Supreme Court of the United States ruled in Quill Corp. v. North Dakota that companies without close ties to a state didn't have to collect tax from customers in that state. However, the growth of ecommerce created a situation states couldn't afford: The loss of tax revenue from buyers purchasing from sellers who had no obligation to collect and remit sales tax. In theory, those buyers should pay use tax on the transactions, but in practice, almost none of them did.

Losses from uncollected tax on remote sales, combined with outdated and inadequate federal legislation, led states to take another tack: They expanded the definition of nexus to include a much wider range of activities – many of which are the very tactics employed by companies to grow their business.

Then, in June 2018, a landmark decision in South Dakota v. Wayfair, Inc., essentially killed the Quill decision. In Wayfair, the Supreme Court ruled that South Dakota had the right to require out-of-state sellers to collect and remit sales tax on taxable sales into the state if those sales met certain revenue or sales volume thresholds. In the wake of this decision, dozens of states quickly passed economic nexus laws of their own.



For more info, check out the **Avalara online guide to sales tax nexus laws by state**.

THE GROWING PAINS OF TAX COMPLIANCE

Below are five activities that high-growth companies undertake that can be a barrier to sales tax compliance:

1. Domestic and global expansion. Physical expansion is still a key factor in business growth for many companies. But operating in more locations can also create new tax obligations, often faster than high-growth companies can adapt. Adding staff who work remotely (or at a home office) in a new state can add obligations to register, file, and remit taxes in that state and all its local jurisdictions. Opening new warehouses or distribution centers – including drop-shipping warehouses – can similarly create new nexus connections. Having nexus in one or two states might be manageable, but once you have nexus in more than five states, sales tax can get exponentially more complicated as rates, rules, and filing requirements can vary from state to state.

Global expansion has its own unique tax challenges. Conducting business overseas is vastly different from the United States. Many foreign markets operate under the value-added tax (VAT) system, which does not follow the same assessment, collection, and payment structure as U.S. sales tax. International transactions also typically involve customs, duties, tariffs, and landed cost, each of which has its own set of rules and complexities. The cross-border tax compliance process can be overwhelming (and risky), which is why many companies resort to hiring intermediaries or export agents to help them, potentially adding to business expansion costs. An automated cross-border tax compliance solution may be worth considering if your growth plans extend overseas.

2. Selling via ecommerce sites or online marketplaces. Reaching new audiences is a key strategy for any growing business. And the internet is a great revenue source: for your business and for state governments. Forty-six states, plus the District of Columbia, Puerto Rico, and cities in Alaska with a local sales tax, now require remote sellers to collect sales tax on ecommerce transactions. Additionally, the state of Missouri has economic nexus laws on the books, which will go into effect on January 1, 2023. In some states, participating in affiliate programs or online advertising is enough to create that connection; 34 states have affiliate nexus laws and more than 20 still maintain click-through nexus laws.

These nexus triggers can affect companies of all sizes, but high-growth and ecommerce companies are primary targets because they are primary users of online marketplaces, digital advertising, and internet referral programs.

If your business sells through these channels or programs to drive sales, be sure you understand how this impacts your nexus and tax compliance.

3. Adding products or services. Growth-driven companies are always innovating, looking for ways to break into new markets or reach more customers. But adding new products or services to your offerings can make compliance tricky, especially in emerging industries like software and digital goods and services where tax laws often haven't caught up with technology. But just because the states aren't early adopters doesn't mean you get a pass on compliance.

Product and service taxability can be difficult to determine. And there is little consistency from state to state. Some products or services are taxable in some states, but exempt in others. Other products and services are sometimes taxable, adding another layer of confusion. For example, in Colorado, straws and cup lids for takeout food are considered taxable, but the cups themselves are exempt. In Texas, customers buying five or fewer donuts have to pay sales tax – maybe it's better to get the half dozen, since buying six or more means the purchase is exempt.

Software companies, in particular, are some of the hardest hit by the complexity of taxability. Currently, 20 states impose sales tax on software as a service (SaaS) and 28 states tax digital goods and products. That could increase as economic nexus laws take hold. Tax rules vary widely state to state, nuanced down to such criteria as physical or digital, custom or canned, or some combination thereof.

Let's say a software company launches a new product and allows customers to buy it both as a physical disc and digital download. Let's also say that support and installation fees are included or available with purchase along with licenses. Depending on the exact nature of the software, any services provided, and the distribution method, this single transaction could be taxed at different rates depending on where it was purchased, who purchased it, and whether it's taxable or exempt or partially exempt based on state or even local jurisdiction rules.

More states are also taxing services. Only a few states tax all services, but most tax at least some services. The sourcing rules for determining obligations can be tricky, especially if you have contractors or outsource these services to third parties. To further complicate matters, economic nexus laws can also apply to the sales of services as well as goods in certain states.

It's easy for high-growth companies to get tripped up by product and services taxability, especially when their focus is on how to add value to the business, not tax liability. To make matters worse, every year, thousands of rate changes, product taxability rule changes, and Department of Revenue rulings are made that affect sales tax on products and services.

4. Filing in multiple states. To stay on the good side of auditors, you should register for sales tax in every jurisdiction where you have nexus. That number is likely to be exponentially larger for many companies now that economic nexus rules apply. Then, you'll likely have to contend with a morass of filing deadlines and requirements that are different in each state. The frequency with which you're required to file, as well as whether you're required to pre-pay part or all of your expected sales tax obligations, can change as total sales made to customers in a state grow. Each state you file in can make your compliance picture exponentially more complex, potentially requiring adoption of new sales tax rules and regulations that can get confusing fast.

Tracking due dates and filing schedules, managing notices from each state's Department of Revenue, filing local returns, managing different payment methods, and forms can become a huge burden. What was once a small annoyance can quickly grow beyond what's reasonable to manage in house, eating up valuable staff time, and becoming a drain on resources and morale.

There may be some reprieve in the form of Streamlined Sales Tax (SST). Participating in SST can help reduce the costs and manual work that goes into complying with multi-state nexus. Eligible businesses willing to work with an SST-certified provider can qualify for low-cost or no-cost tax automation services, including registration and return filing in 25 participating states.

5. Gaining a high public profile.
Congratulations, your company's making headlines! Idea-to-IPO success stories study the news daily, and investors, analysts, and consumers are swift to home in on the hottest companies to hit the market. This high visibility is great for growth, but it can be a magnet for states – and state auditors – looking to draw in more tax revenue from profitable ventures. Companies with a higher profile and higher revenues tend to be chosen for audits more often. And if you have multi-state nexus, you could be looking at multiple audits. Bottom line: automate to help avoid risk.

High-growth companies can't afford for sales tax to slow them down. State sales tax authorities traditionally watch companies closely in industries where compliance has historically been more relaxed. One costly sales and use tax audit could spell major problems, especially if you are anticipating a liquidity event.

Compliance problems often multiply during high-growth periods. When manual compliance starts to create problems, it's time to automate. Dozens of business processes are now handled through software and SaaS solutions. Sales tax is no exception. Tax automation software integrated into your existing ERP, ecommerce, or billing system is an easy, affordable, and reliable way to stay on top of tax compliance as you grow.

Go with the best.

The end-to-end sales tax compliance solution from Avalara scales with your company at every phase of growth. Our industry-leading tax calculation engine is fast, and our cloud-native solutions update your tax records in real time so there is less worry about compliance. Avalara can help you feel confident that every jurisdiction, every rate, every regulation is highly accurate and accounted for. We even offer an Accuracy Guarantee.

With Avalara, filing and remitting taxes no longer has to be a time-consuming chore involving remitting separate checks for each jurisdiction and filling out a range of different forms. Instead, automated filing means you review a brief report, then click to pay. Avalara uses just one direct deposit from your company, automatically dividing up the total and remitting the correct amount to each jurisdiction.

Prebuilt integrations mean that you can get automated tax compliance while still using the ERP or accounting software you're already familiar with – and our wide range of integrations (along with an API for companies that aren't using one of our more than 1,000 signed partner integrations) means that even when you change software, you can keep the services you've grown to trust from Avalara.

Don't wait until you've outgrown your current system to get a solution that scales with you – wherever you grow.

Visit avalara.com today for more information about how Avalara can make compliance easier for your high-growth business.

Avalara

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