

# SALES TAX 101



SALES TAX  
INSTITUTE<sup>SM</sup>

On-Demand Webinar



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# Agenda

- Understand the difference between sales tax and use tax
- Learn the definitions of important sales tax terms
- Understand the concept of nexus
- Discover the four main types of sales tax exemptions
- Learn how to calculate the tax base to which sales and/or use tax apply
- Learn how and when to file and remit your taxes



# Definitions

# General Comments

- Definitions differ by jurisdiction - some exemptions are embedded in the definitions
- Know your business and read the law

# Sale

- Any transfer of **title or possession**, exchange or barter, conditional or otherwise, in any manner by any means whatsoever of **tangible personal property** for **consideration**

# Sales Tax

- A tax on the sale, transfer, or exchange of a taxable item or service
- Applies on the sale to the end user or consumer
- Added to Sales Price and charged to purchaser
- Applies to intrastate sales
- Trust tax

# Use

- The **storage, use or consumption** of **taxable** property or services and includes the **exercise of any right or power** incident to the ownership of the property



# Use Tax

- A tax on the storage, use, or consumption of a taxable item or service on which no sales tax has been paid
- Complimentary to Sales Tax
- Purchases made outside the taxing jurisdiction, but used within

# Use Tax (cont.)

- Two types - Consumers Use and Vendor/Retailer Use
- Consumer's Use Tax is a tax due by the purchaser when the vendor didn't collect sales tax
- Seller's Use Tax is a tax collected by a registered vendor for interstate sales

# Tangible Personal Property

- **Personal** property which can be seen, weighed, measured, felt, touched or anything that is **perceptible to the senses**
- Anything that isn't real property
- Some states may add items to the definition

# Intangible Personal Property

- Generally includes stocks, contracts, mineral rights, patents, copyrights, and other similar items
- May be considered tangible if delivery on a tangible medium

# Real Property

- Land, buildings, fixtures, and structures affixed or attached to the land or buildings
- Temporary vs. Permanent Affixation to real property

# Services

- The occupation or function of serving, repairing or providing an activity to satisfy a public demand
- Incidental service or incidental property
- States vary as to what is incidental
- Services must be separately stated



Nexus

# Nexus – Physical

- A level of connection between a taxing jurisdiction and an entity. Required before a taxing jurisdiction can impose its taxes on a business
- Due Process Clause and Commerce Clause
- *Quill Corporation v. State of North Dakota*



# Nexus – Physical (cont.)

- Retailer engaged in business is maintaining, occupying or using **permanently or temporarily, directly or indirectly** or through a subsidiary, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business in the jurisdiction

# Nexus – Physical (cont.)

- Having a representative, **agent**, salesman, canvasser, or solicitor operating in this state under the **authority** of the retailer or its subsidiary on a **temporary or permanent** basis

# Nexus – Remote Seller

- **Click-Through Nexus** can be establish through the payment of commissions for successful completion of an order through a referral mechanism
- **Affiliate Nexus** can be established through an entity with common ownership in the same or similar line of business with same or similar name in many states

# Nexus – Remote Seller (cont.)

- *South Dakota v. Wayfair, Inc. (June 21, 2018)*
  - Created economic nexus standard which creates nexus based on substantial presence (physical presence not required)
  - Most states follow South Dakota's threshold:
    - \$100,000 GROSS sales in a year OR
    - 200 transactions (invoices) in a year
  - Some exceptions on thresholds as well as definition of sales
  - States are enforcing prospectively

# Nexus – Remote Seller (cont.)

- **Economic Nexus** can be established without physical presence in the state when a retailer meets a set level of sales transactions or gross receipts activity within the state
- **Marketplace Nexus** can be established by an online marketplace operating in the state that provides e-commerce infrastructure to many sellers – the marketplace facilitator is required to collect tax as the retailer rather than individual sellers

# Nexus – Remote Seller (cont.)

- **Reporting Requirements** legislation requires that a retailer notify buyers of their use tax obligations. The retailer may also be required to send buyers an annual statement of purchases
- Remote Seller Nexus Chart:  
<https://www.salestaxinstitute.com/resources/remote-seller-nexus-chart>



# Exemptions

# Exemptions

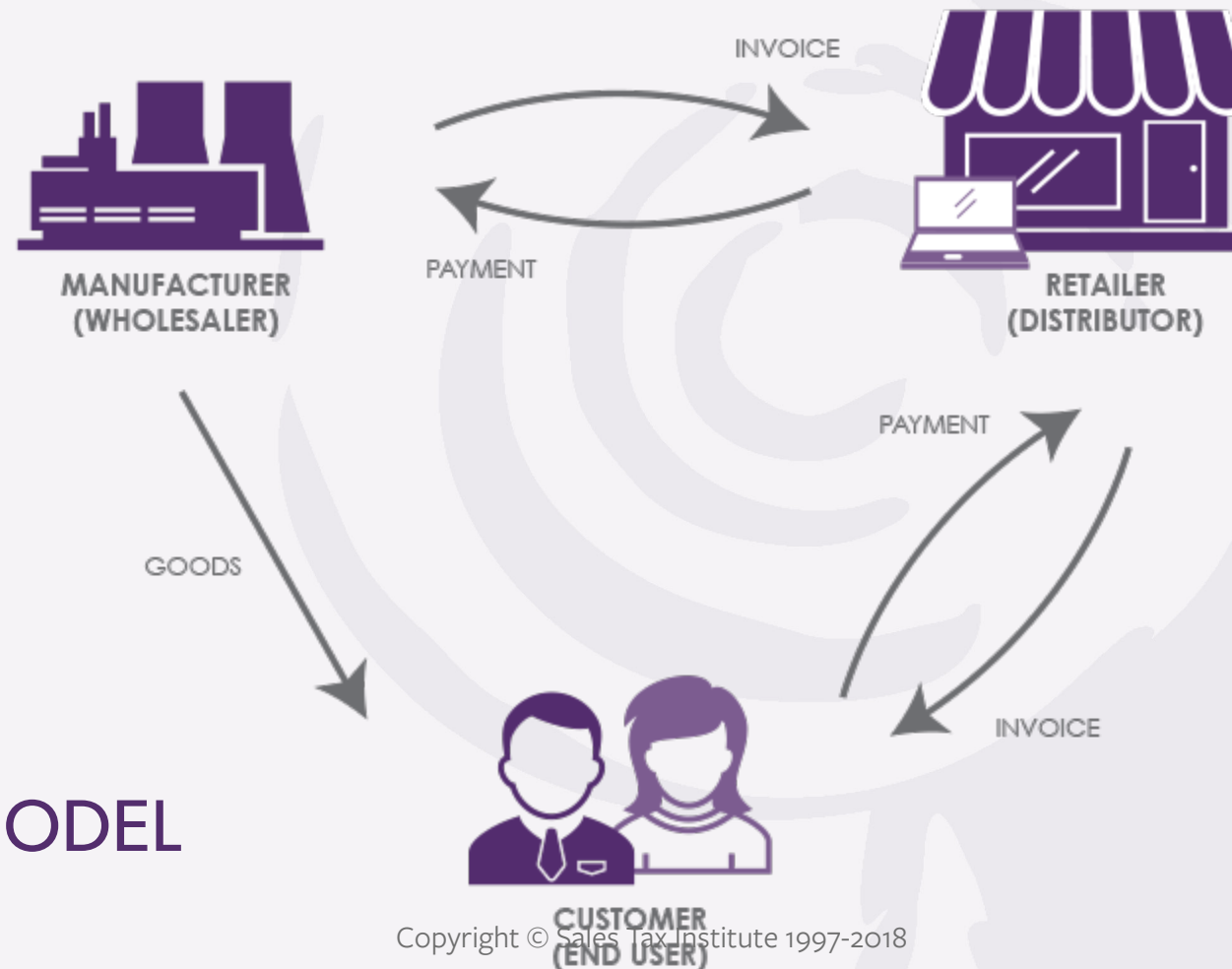
- Exempt Transactions
- Exempt Purchasers
- Exempt Use
- Exempt Items



# Exempt Transactions

- States have enacted exemptions on type of transaction
- Resale Exemption
  - Sales Tax is imposed on the Retail sale
  - Intermediary sales in the production process are exempt
  - Ultimate sale is taxed at retail selling price
  - Generally must become part of the product sold
  - Usually must be considered taxable tangible personal property
  - Documentation

# Drop Shipments



## THE DROP SHIPMENT MODEL

# Sales & Use Tax Issues for Drop Shipments

- Retailer/seller is not registered in delivery state
- Resale documentation
- Delivery modes
- Customer is reseller
- Customer is exempt organization
- Shipping Terms
- Is Manufacturer required to collect tax?
  - What is tax base?
- Tax reimbursement charges on invoice?

# Exempt Transactions (cont.)

- Interstate Commerce Exemption
  - Sales Tax is imposed on sales within a jurisdiction
  - Sales in interstate commerce cannot be taxed by the selling jurisdiction
  - Destination state will likely tax under use tax
  - Documentation

# Exempt Purchasers

- Granted under state statutes
- Federal Government
  - States are prohibited from taxing the Federal Government under U.S. Constitution
  - Some states specifically include an exemption
  - Government contractors may be taxable
  - Documentation

# Exempt Purchasers (cont.)

- State and Local Government
  - Exemption is by grace of legislature
  - Exemptions to other states
  - Don't assume a government sale is exempt
  - Exemptions may be provided under other exemptions (schools)
  - Documentation

# Exempt Purchasers (cont.)

- Exempt Organizations
  - States can choose to tax or exempt
  - Strict requirements must be met. Sales Tax exemption tied to either IRC 501 or purpose of organization
  - States require application
  - Exemption for sales by and purchases by organization
  - Documentation

# Exempt Use

- Historically, these exemptions encourage investment in the state
- Documentation



# Exempt Use (cont.)

- Manufacturing
  - What is manufacturing? It's not what you think!
  - Examples: machinery, repair parts, utilities and packaging
  - Beginning & end of the process
  - Predominate or exclusive
  - Direct or indirect use
  - New or replacement machinery

# Exempt Use (cont.)

- Other Types of Exempt Use
  - R&D
  - Call Centers
  - Agriculture
  - SpacePort
  - Warehousing
  - .....

# Exempt Items

- States vary on what types of items they may exclude from their tax base
- Typical exempt items across states include:
  - Food
  - Medicine
  - Services
  - Intangibles
- Documentation

# Exemption Certificates

- Key components of exemption certificate
  - Seller name and address
  - Purchase name and address
  - Registration/Exemption Number
  - Description of Item Purchased
  - Exemption Reason
  - Indemnification Statement
  - Signature of Purchaser and Date

# Exemption Certificates (cont.)

- Multi-jurisdictional Exemption Certificate
  - MTC Form: <http://www.mtc.gov/Resources/Uniform-Sales-Use-Tax-Exemption-Certificate>
  - SST Form:  
<http://www.streamlinedsalestax.org/uploads/downloads/Forms/Fooo3%20Exemption%20Certificate%20Fillin%205-11-2018.pdf>
- Originals
- Expiration



# Industry Issues

# Software

- Software poses challenges in taxation due to nature of delivery and related services
  - Canned Software delivered tangibly is always taxable
  - Custom Software is often a service and could be exempt
  - Canned Software electronically delivered and downloaded could be taxable or an intangible
  - Software as a Service could be canned software, an information service, a telecommunication service or an intangible
  - Sourcing software can vary but trend is based on location of user

# Construction

- Construction Contractors
  - Real Property is not generally subject to sales tax by definition
  - Considered retailers for property sold that retains its character after installation
  - Tangible property vs. real property
  - Considered consumers of items incorporated into real property
  - Pay tax on materials when you buy them



# Services

- Service Transactions
  - Services are often not taxable in some states
  - Taxable services usually involve the repair and maintenance of tangible personal property
  - New sources of revenue for states
  - States that generally tax services
    - South Dakota
    - New Mexico
    - Hawaii
    - West Virginia



# Tax Base

# Tax Base

- The value of the items that are subject to sales or use tax.
- Defined as the total amount of the sales price, without any deduction for the cost of the goods sold, interest paid, other expenses or transportation

# Tax Base (cont.)

- Taxable and Non-Taxable components must be separately stated to preserve the non-taxable portion
- Tax Base is adjusted for exemption, exclusions or deductions

# Tax Base (cont.)

- Bad debts
- Discounts
- Trade-ins
- Freight and transportation out
- Installation
- Interest, finance & carrying charges
- Refunds & returns
- Other taxes and license fees



# Filing & Remitting Taxes

# Registration

- If you're there - register
- How to register
- What tax are you subject to?
- How often will you have to file?
- When did you enter the jurisdiction?

# Registration Considerations

- Statute of Limitations issues
- Obtain exemption certificates
- Voluntary Disclosure Programs
- Amnesty Programs: <https://www.salestaxinstitute.com/resources/sales-tax-amnesty>
- Talk to your customers
- When should you register
- Tax must be collected and use tax remitted on purchases but don't start collecting without registration!



# Differences Between States & Localities

- Every State is Different - don't assume you know the answer
- Most states allow local taxes
- 14 states either have very few localities that impose a tax or none at all
  - <https://www.salestaxinstitute.com/resources/rates>
- Most locals follow same rules as their state

# Differences Between States & Localities (cont.)

- Some items have a reduced rate at state level and are exempt locally
- Home-rule jurisdictions administer taxes separately from states
- Combination of home-rule and state administered: Alabama, Arizona, Colorado, Illinois, Idaho
- Full home rule: Alaska and Louisiana

# Sourcing of Sales Tax

- Sales tax applies based on the state where the property is delivery/used
- For intra-state sales – some states source the local tax to the origin; most to destination
- For inter-state sales – all states source local tax to the destination
  - Not every state imposes a local use tax when they impose a local sales tax

# Return Preparation

- Filed on a timely basis
- Generally due in the month following the taxable event
- Due dates vary by jurisdiction
- Prepayments
- Vendor discounts
- EFT
- EDI

# Questions & Comments

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# Thank you for watching!



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