

Starting a New Business or Initiative: What You Need to Know for Sales Tax



SALES TAX
INSTITUTESM



Diane L.
Yetter

- Strategist, advisor, speaker, and author
- President of YETTER
- Founder of the Sales Tax Institute
- Accounting Today's 100 Most Influential People in Accounting for 2011, 2012, 2017 and 2018



Introduction

Introduction

- Whether you're starting a new business or starting something new in an existing business, there are sales tax implications that you need to think through.
- New sales tax requirements arise whether you're selling something new, selling on a new channel, or selling to new customers.

Introduction

- Examples:
 - Previously selling only products, now also selling services (and vice versa)
 - Changing your product line or selling new products
 - Selling new services
 - Previously selling to distributors, now also selling to end-users (and vice versa)
 - Selling only on Amazon, now also selling directly to customers on your website (and vice versa)



Selling New Products/Services

Selling New Products/Services

- If you are selling a new product or service, you need to be aware of the sales tax implications of those sales.
- Understanding what is bought and sold and how any given state will classify is critical to proper tax calculation
- Need to look for the lowest common denominator in product classification
- Importance of language
- Invoice and contract presentation

Sales of Tangible Personal Property (TPP)

- Often defined as personal property which can be seen, weighed, measured, felt, touched or anything that is perceptible to the senses.
- Some states define tangible personal property as anything that is not real property.
- Some states have added to their definition of TPP items which they would like included, but otherwise may not be considered TPP like utilities and software

Sales of Tangible Personal Property (TPP) (cont.)

- If you are making new sales of TPP, you'll need to determine the taxable/exempt status of what you're selling.
- States may exempt certain types of TPP or tax them at a reduced rate.
 - Examples: clothing, food
- Also be aware of the nuances that can come with selling a new product in the same category.
 - Example: prepared food vs. unprepared (grocery) food

Sales of Services

- Professional Services
 - Generally states exempt sales of professional services.
 - Professional services including accounting, legal, medical, engineering, architecture, advertising and other services where the charge by the provider is for their expertise and there is really no tangible personal property involved in the rendering of the service.
 - Materials used by the professional service provider are subject to tax when purchased. This generally includes materials that may be transferred to the service customer as an incidental part of the service.
 - Most service providers should be registered for use tax in the states where they maintain offices.

Sales of Services (cont.)

- Professional Services
 - Some states do tax various professional services. The types of services taxed generally include professions where the service results in a tangible delivery like architectural services and engineering services.
 - Although many states do not tax professional services, this is an area that states are considering taxing, often as part of a broader tax policy change.
 - Other states tax business services such as human resources services, which can include temporary help, recruiting, background checks.

Sales of Services (cont.)

- Repair and maintenance of tangible personal property are commonly included as specified services that are subject to tax in states that take that approach.
- Repair = break/fix
- Maintenance = maintain in good working order

Sales of Digital Goods

- The Streamlined Sales Tax (SST) definition of “specified digital products” means electronically transferred:
 - “Digital Audio-Visual Works” which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.
 - “Digital Audio Works” which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.
 - “Digital Books” which means works that are generally recognized in the ordinary and usual sense as “books.”
- Non-SST states may consider digital goods to be TPP or included in a definition of a taxable computer service.

Invoice and Contract Presentation

- Generally, items must be separately stated on the invoice provided to the customer for any exemption or exclusion to apply.
 - For example, if there are charges for installation, delivery, training or another exempt service, do not include those charges in the single price for the item.

Invoice and Contract Presentation (cont.)

- The terminology used to describe the item being sold has a significant impact on the taxability determination.
 - Repair vs. Maintenance
 - Installation vs. Fabrication
 - Delivery charges, freight, postage, shipping and handling
 - Software License vs Software as a Service
- Consistency is crucially important when it comes to contract and invoice presentation.

Historical Treatment of Bundled Items

- Streamlined Sales Tax Rules for Bundled Transactions
 - A “bundled transaction” is the retail sale of two or more products, except real property and services to real property, where (1) the products are otherwise distinct and identifiable, and (2) the products are sold for one non-itemized price.
 - A “bundled transaction” does not include the sale of any products in which the “sales price” varies, or is negotiable, based on the selection by the purchaser of the products included in the transaction.
 - Additional rules for a bundled transaction that includes any of the following: telecommunication service, ancillary service, internet access, or audio or video programming service.

Historical Treatment of Bundled Items (cont.)

- What is the risk of taxing the components, and what should be done?
 - Absent a state specific ruling, the state can follow their general rules regarding true object. However, some companies are starting to tax each component based on an allocation percentage of the components.
 - Using an allocation method may result in customer inquiries and risk that a customer that doesn't take advantage of all components may request price reductions to eliminate the components they are not using.
 - There is still risk that a state may not allow the allocation method and this risk should be fully evaluated.

Other Items to Examine when Classifying Products

- Labeling and Descriptions
 - Look at all sources including marketing materials, order forms, price lists, web site, product labeling (Food vs Supplement)
- Ingredients
 - Flour for candy
 - Milk for soft drink
- Pricing
 - Bundling
- Ancillary Charges
 - Are they mandatory or required?
 - Bundled (Shipping & Handling)



Nexus

Nexus

- If you are selling new products/services or selling on new channels, you need to be fully aware of where you may be creating new sales tax nexus obligations.

Nexus (cont.)

- Defines a level of connection between a taxing jurisdiction and an entity
- Controlled by U.S. Constitution under the Due Process Clause and the Commerce Clause
- Supreme Court has shaped the definition of Nexus
- “Substantial presence”
 - Physical activities of individuals or presence of property
 - Still relevant post-Wayfair

Nexus (cont.)

- 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
- 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 (cont.)

- The U.S. Supreme Court's decision in *South Dakota v. Wayfair* struck down the physical presence requirement.
- Remote seller nexus legislation has proliferated in recent years:
 - Click-through nexus
 - Affiliate nexus
 - Economic nexus
 - Marketplace nexus
 - Notice and Reporting Requirements

Nexus (cont.)

- Changes in what and how you are selling can affect both your physical presence nexus and economic nexus, so you'll need to perform a nexus evaluation.
 - If you previously only sold services but are now selling tangible personal property, you may be creating physical presence nexus in states.
 - If you are now selling taxable TPP, you may have new economic nexus obligations.
 - If you are starting to sell your products on Amazon (FBA), you may be creating physical presence nexus in states.

Nexus (cont.)

- Steps for Nexus Evaluation
 - Do I have physical presence in the state?
 - If yes, need to register for sales tax and maybe income tax
 - No physical presence then look for remote seller activities
 - Click Through
 - Affiliate
 - If yes, need to register for sales tax, likely not income tax
 - No remote seller activities, then economic
 - Sales Thresholds
 - Marketplace collection
 - If yes, need to register for sales tax, likely not income tax
 - No activities that require registration
 - Does the state have notice and reporting requirement?
 - Or is it easier to collect?

Economic Nexus

- Does not require physical presence
- Correlates with a set level of sales or gross receipts activity
- Many states' threshold is \$100,000 or 200 transactions but seeing a trend to have a flat dollar threshold
- Threshold is most often gross sales but some states have retail sales and a few have taxable sales

Marketplace Nexus

- Requires online marketplace facilitator to collect tax on behalf of sellers operating through their systems
- Typical requirements include that the marketplace facilitator collects revenue from the customer and manages multiple activities related to the selling process
- Key provisions relate to collection of sales revenue from customer
- If marketplace doesn't collect, seller is still responsible. If you sell through a marketplace, you need to confirm if they're collecting or not.

Nexus (cont.)

- Resources
 - Remote Seller Nexus Chart
 - <https://www.salestaxinstitute.com/resources/remote-seller-nexus-chart>
 - Economic Nexus State Guide
 - <https://www.salestaxinstitute.com/resources/economic-nexus-state-guide>
 - Remote Seller Resource Page
 - <https://www.salestaxinstitute.com/resources/remote-seller-resources>



Selling on New Channels

Selling on New Channels

- Selling your products on new channels will have sales tax implications.
- Selling through your own website
 - If you previously sold exclusively on a marketplace provider (such as Amazon) that collected sales tax on the transactions and you are now selling on your own website, you'll need to register and collect and remit sales tax on taxable sales.
 - You will need tax calculation functionality in your shopping cart
 - You'll need to be aware of the “ship-to” location and ability to set product taxability by state or have functionality to a tax bolt on system

Selling on New Channels (cont.)

- Selling through a marketplace provider
 - If you are going to sell your products exclusively through a marketplace provider, you'll have to determine if you need to collect and remit tax in states that don't have marketplace nexus legislation.
 - Make sure that your products are classified properly for taxable/exempt status within the marketplace
 - If you sell multi-channel, economic nexus might change
 - If you have exempt customers, you will need to determine if the marketplace can handle this requirement
 - If you are becoming an Amazon FBA seller and storing inventory in numerous states, you are creating physical presence nexus in those states which could impact your off marketplace registration requirements.

Selling on New Channels (cont.)

- Selling at a brick and mortar store
 - If you previously only made online sales and are opening a brick and mortar store, you are creating physical presence nexus.
 - This may require business license and other permits
 - If you only had a brick and mortar store before and are now making sales through your own website, you will need to monitor your economic nexus across the states.



Registration

Registration

- After a nexus study has been conducted to determine where a taxpayer has a presence, registration must occur.
- Every state has different questions on their application form.
- Populate a questionnaire with the common information to aid in completing the applications

Registration (cont.)

- You'll need to determine which taxes you will be required to collect or pay.
 - Some states differentiate between sales tax, seller's use tax and consumer's use tax on both their registration application and return.
 - How the taxpayer registers can impact the return they are required to file and the rate they are required to collect.
 - If you're an e-commerce seller, you should be registered for seller's use tax generally but a few states like CO are requiring sales tax.
 - Multi-channel particularly with a physical location could require multiple registration types

Registration (cont.)

- Filing Frequency
 - Some states don't request the average liability but ask you to identify your filing frequency.
- Due Dates
 - The filing frequency will dictate the due dates for returns
 - Returns are due in the month following the end of the period on the specified due date
 - Returns must be filed by the due date and the tax paid by the due date

Registration (cont.)

- Most applications also request the date that business began in the jurisdiction.
 - Used to determine if returns are due for prior periods
 - If a prior period is listed, expect to receive these returns with interest and penalty notices.
- Nexus date
 - If registration form is being filed for a business that has had nexus for some period of time, careful attention must be given to answering the date question.

Registration (cont.)

- If there is a secretary of state line on the registration form, don't automatically assume that you need to register with the secretary of state.
- Secretary of State registration is typically a legal evaluation.
- Registering with the secretary of state unnecessarily could result in additional filing and fees
- Physical presence could require secretary of state registration

Registration (cont.)

- Applications must be completed accurately to the best of your knowledge.
- Applications are signed/submitted under penalty of perjury
- Registration application forms can be obtained from the Department of Revenue of the jurisdiction.
- Online registration is the preferred method and may be the only option.
- Paper forms – may be necessary if can't skip questions online that don't apply (Sec of State, SSN)

Registration (cont.)

- Streamlined Sales Tax (SST) Registration Process
 - Consideration should be given to registering through the SST system for participating states.
 - 2019 change allows registrants to select which states to register in
 - Significantly fewer questions and requirements especially helpful for foreign entities as no requirement for FEIN or social security numbers for officers

Registration (cont.)

- Streamlined Sales Tax (SST) Registration Process
 - Benefits
 - Limited questions
 - Ability to easily update information for all states when needed
 - Can identify remote seller or not
 - Risks/Limitations
 - Limited start date to only up to 60 days in the past
 - Participating states where you don't register could discover you but they don't receive notification that you didn't register
 - Future functionality may include ability to register non-SST states through the system

Registration (cont.)

- Registration Certificate
 - Number is used to complete resale certificates to provide to suppliers for inventory and items incorporated into property to be sold
 - Certificate is required to be posted in your physical location
 - Maintain original copies in a safe place in case you need to cancel registrations
 - Use this number for online marketplaces and tax engines to turn on the state



What To Do When You Change Your Business Entity

Change of Registration

- A complete change of registration may be required if any of the following happen:
 - Name change
 - FEIN change
 - Corporate entity type change
 - Merger or sale of business units

Change of Registration (cont.)

- You may need to notify the Secretary of State before a sales/use registration change can happen
- You may need to surrender the old registration certificate
- If a registration is closed due to the sale or merger of an entity, file a final return and return your license



Exemption Certificates

Exemptions

- There are three basic categories of exemptions:
 - Transaction exemptions (e.g. Sales for resale)
 - Usage exemptions (e.g. Manufacturing, R&D, High Tech)
 - Entity exemptions (e.g. Gov't agency, Non-profit organizations)
- If you are moving into a new field such as manufacturing, research and development, or high-tech, there is a good chance that you may qualify for exemptions. You'll want to research available exemptions in the state(s) for the new field you are entering.

Exemptions (cont.)

- If you're making a change in who you're selling to, you may be creating exemption certificate obligations.
 - Example: Previously sold to end-users, now selling to distributors (and vice versa)
- If your business previously made B2C sales and you're now making B2B sales, chances are good that you're making sales for resale and will need to collect exemption certificates instead of collecting sales tax.
- If moving into B2B sales, a number of different exemptions may apply.

Exemptions (cont.)

- If you are now making sales to exempt customers, you need to begin collecting exemption certificates.
- Exempt customers must declare their exempt status and provide documentation.
- If documentation isn't captured, the tax liability can become the seller's responsibility at time of audit.

Exemptions (cont.)

- Exclusions are statutory and apply regardless of the customer and do not require exemption documentation
- Common exclusions include services, clothing, food, and medicine
- If you are selling a new product or service that is exempt, you don't need to do anything special other than confirm classification and taxability.

Exemption Documentation

- Understanding the rules in each jurisdiction is important
 - Each state may have specific guidelines for the type of certificate it will allow. Not all will accept the generic or multi state forms for nonprofit/government exemptions
 - 38 states accept the Uniform Multijurisdiction Exemption Certificate.
 - <http://www.mtc.gov/Resources/Uniform-Sales-Use-Tax-Exemption-Certificate>
 - Some have their own stipulations along with the uniform certificate.
 - The Streamlined Sales Tax (SST) Exemption Certificate is valid in member states
 - <https://www.streamlinedsalestax.org/Shared-Pages/exemptions>

Exemption Documentation (cont.)

- Documentation
 - Applicable Jurisdiction
 - Blanket vs. Single
 - Purchase Order Certificate
 - Good Faith
 - Paper vs. Imaged
 - Electronic Certificate
 - Registration/Exemption Number
 - Renewal Period/Expiration Date

Exemption Documentation (cont.)

- It is the seller's duty to maintain current records of exemption certificates
 - Exemption certificate must be held until a new one is issued
 - Expired or updated certificates should be maintained until the period is closed for audit
- In Seller Privilege States (e.g. California, Arizona), the seller is primarily liable for the tax. If the purchaser didn't issue a certificate and the supplier didn't charge tax and it's an in-state supplier, the purchaser doesn't owe use tax.

Exemption Certificate - What's Required?

- Name & address of seller
- Name & address of purchaser
- Registration/Exemption number of purchaser
- Description of property purchased
- Reason for exemption
- Indemnification statement
- Date & signature of purchaser

Exemption Certificate Renewal Periods

- Renewal periods for exemption certificates vary by state and type of exemption
 - Some states' exemption certificates do not expire.
 - Other states' certificates expire within a set period of time, frequently 3-5 years.
 - It is recommended that sellers update all certificates that don't otherwise expire every 3-5 years.
 - Retain all prior certificates that could be required under audit.

Resale Certificate

- Signed document which indicates that the purchaser intends to resell the goods. It is usually provided by a retailer to a wholesale dealer.
- Usually provided as “blanket” form. This means that the resale certificate applies to all items purchased from the vendor.
- Some states require their own specific certificate. Other states will accept the Multi-Jurisdictional Exemption Certificate or the Streamlined Sales Tax Exemption Certificate. Still others will allow a statement of resale on the purchase order.
- Some resale certificates expire. Update regularly.

Drop Shipments

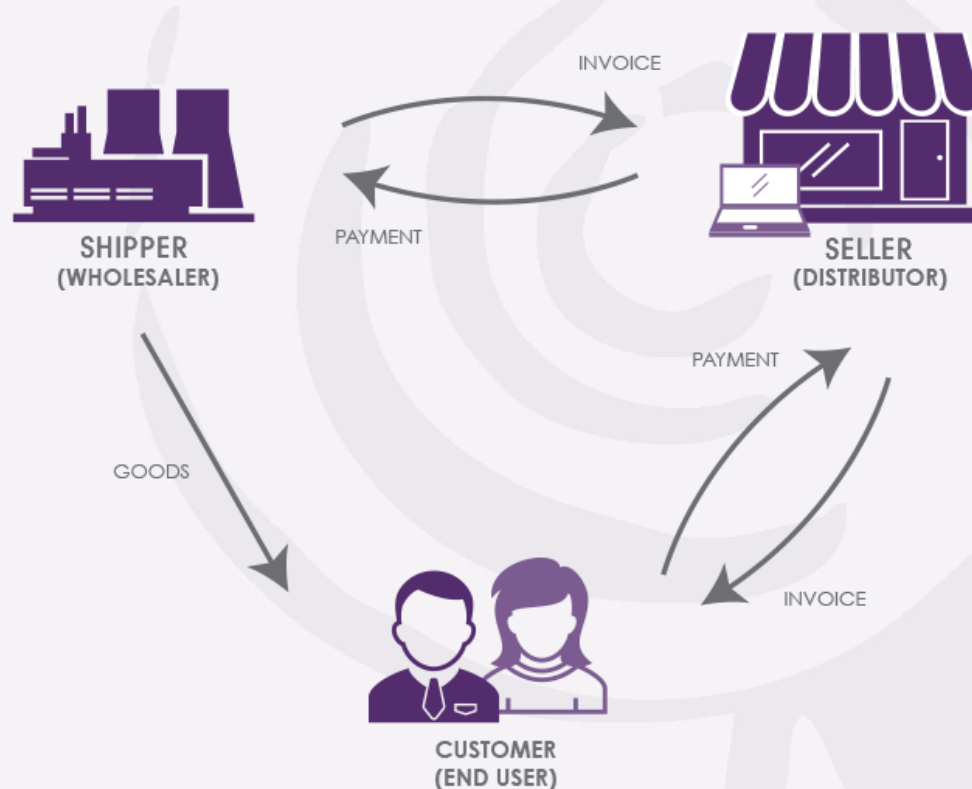
- If drop shipments are a new part of your business model, you'll need to understand the sales tax implications to your business.
- If you are moving into buying and reselling, there is a greater chance that drop shipments are involved and you'll need to be aware of your exemption certificate obligations.

Drop Shipment Definition

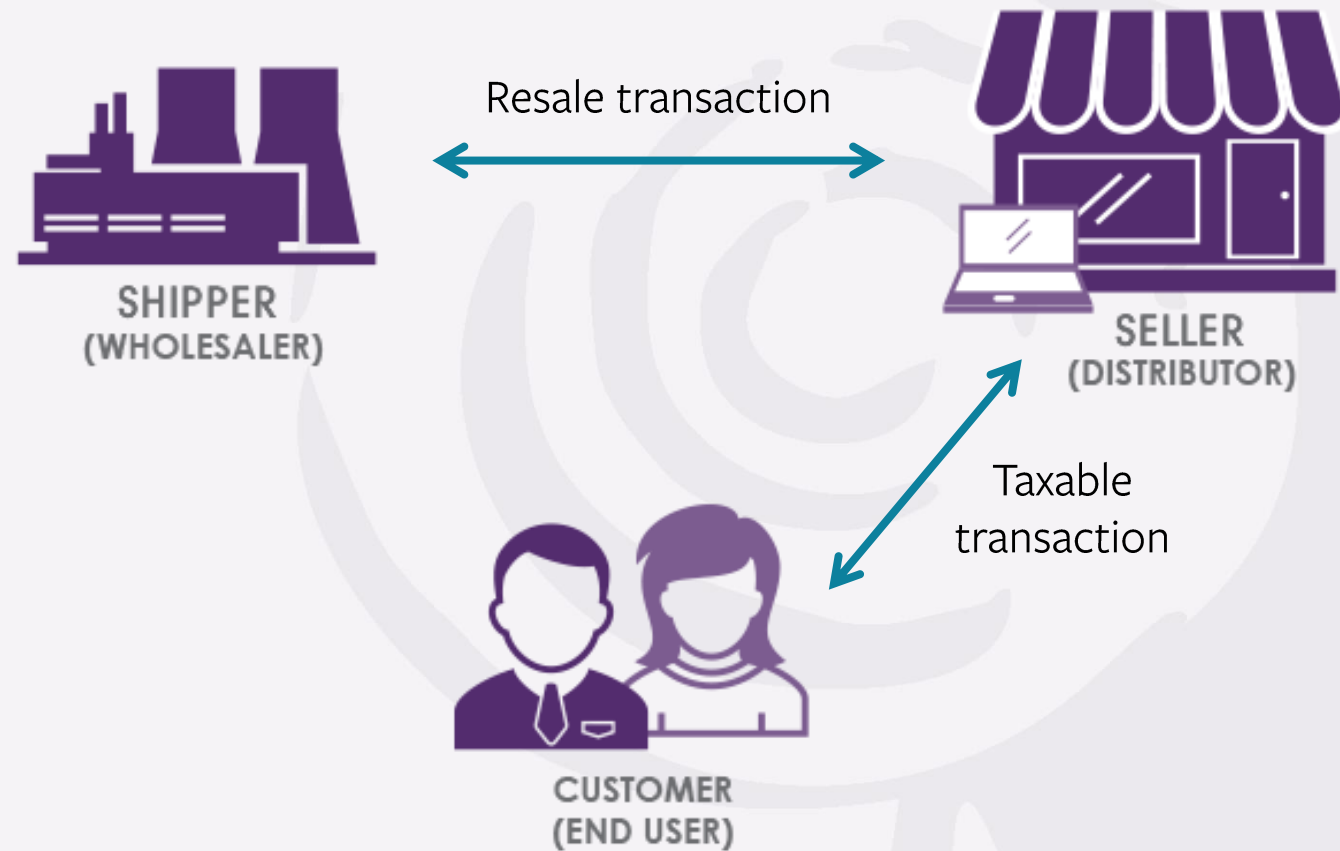
- Seller/distributor accepts order from customer/end user
- Seller/distributor places order with shipper/wholesaler
- Seller/distributor directs shipper/wholesaler to ship goods direct to customer/end user
- Shipper/wholesaler bills the Seller/distributor at wholesale price
- Seller/distributor bills customer at retail price

The Drop Shipment Model

THE DROP SHIPMENT MODEL



Implications of Drop Shipments



Implications of Drop Shipments (cont.)

- What is the appropriate documentation to support the exempt transaction?
 - Some jurisdictions allow alternate documentation
 - Some states require their own registration number
 - Some states accept a pass-through exemption

Implications of Drop Shipments (cont.)

- A state cannot require out-of-state businesses to register to collect its tax unless nexus is established
 - If the shipper/wholesaler requires appropriate exemption documentation, the retailer may be forced to register.
 - Otherwise the shipper/wholesaler will be required to charge tax on the invoice to the retailer.
- To learn more about drop shipments, register for our December 19 “Drop Shipments: What Are They and What’s New Post-Wayfair?” webinar: <https://www.salestaxinstitute.com/sales-tax-education/drop-shipments-what-are-they-and-whats-new-post-wayfair-webinar>

Exempt Organization Certificates

- Document provided by the purchaser to the vendor indicating that the purchaser is a qualified exempt organization under the laws of the purchaser's state
- The federal IRS letter granting 501 exempt status generally does not meet the requirements for state purposes on its own.
- Just because an organization is exempt federally does not mean they are guaranteed an exemption from sales tax.
- The purchase must generally be made directly by the organization and paid for with the organization's funds.

Exempt Use Certificates

- Document provided by the purchaser to the vendor to substantiate a particular use of the goods purchased
- In order for an exempt use certificate to be valid, a description of the use of the property is required. In some states, blanket certificates are not acceptable.
- Many states have special forms for the different types of exempt use. Exemptions claimed on incorrect forms may be considered invalid.

Exemption Certificate Maintenance Best Practices

- Get certificates for all claimed exemptions including in states where you aren't registered to ensure you don't incur liability if you exceed economic nexus thresholds
- Match customer names in your system with customer names on the certificates
- At a minimum, confirm the right number format for the exemption number
- Some states provide ability to validate certificates, or require it
- Maryland, Kansas and North Carolina provide online verification tools.

Exemption Certificate Issuance Best Practices

- Keep track of who you have issued exemption certificates to.
 - If the law changes, and you need to rescind or modify your exemption certificate, you'll know who to contact.
 - This can also help you get out of an audit assessment.
- Post-Wayfair, it is important to do a thorough review of your purchases from suppliers and to continue to monitor this.
 - Companies may now be collecting tax because you haven't issued them an exemption certificate since they weren't charging tax pre-Wayfair.
 - Make sure all exemptions you're entitled to are being honored.



➤ Tax Functional Solutions

Tax Functional Solutions

- If you are now required to collect tax, you'll need to consider your options for these tax function solutions:
 - Sales and Use Tax Calculation Tools
 - Sales and Use Tax Compliance Tools
 - Exemption Certificate Management Tools

Sales and Use Tax Calculation Tools

- Rate automation tools
- Sales tax calculation automation tools
- Procurement tax calculation automation tools

Sales & Use Tax Compliance Tools

- Compliance challenges
 - Determine, report and remit tax liabilities
 - Returns filed timely on acceptable medium
 - Sales and use tax returns due within a 10-day period
 - Many taxpayers required to file electronically
 - Some states accept only state provided forms

Sales & Use Tax Compliance Tools (cont.)

- Custom Templates
- Forms packages
- Calculating forms
- Interactive download forms
- State Online Filing

Exemption Certificate Management Tools

- Forms packages
- Validation packages
- Calculation system interactive packages
- Hosted and Service Solutions



Consumer's Use Tax

Consumer's Use Tax

- New changes in your business operations may create a consumer's use tax obligation for you.
- “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
 - Complementary to sales tax and does not apply if sales tax charged
 - Applies to purchases made outside the taxing jurisdiction but used within the state
 - Also applies to items purchased exempt from tax, but subsequently used in a taxable manner

Consumer's Use Tax

- Purchases of taxable property where the seller did not collect sales or seller's use tax are subject to consumer's use tax
 - The determination of the correct local rate to apply generally follows the seller's use tax rules
 - However, in some states, if the seller and purchaser are located in the same state, special rules may apply
 - In some instances, the tax is imposed on the seller and if the purchaser did not provide an exemption certificate to the seller, the purchaser does not owe the consumer's use tax. This is very state-specific and the particular rules must be reviewed in detail.

Use Tax Base

- The value of the items that are subject to sales or use tax
- Generally 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
- Taxable and Non-Taxable components must be separately-stated or the entire cost becomes subject to tax. There are a few exceptions to this rule if the taxable component is incidental to the non-taxable portion.

Use Tax Base

- The tax base may be adjusted for exemptions, exclusions, or deductions that are determined by specific statutory authority
- Exclusions could include:
 - discounts
 - trade-ins
 - freight and transportation charges (freight out),
 - installation
 - interest, finance or carrying charges
 - refunds and returns
 - other taxes and licenses

State Audit Activity

- State economic situation is resulting in more audits and more aggressive audits
- Penalties are being assessed more aggressively for non-compliance
- Subsequent audits without corrective actions are being assessed higher penalties or automatic penalties

How States Target Possible Audits

- Nexus inquiries
- Late filed returns
- Large refund request
- Large fluctuations in tax liabilities reported
- Audits of your partners
- Recurring compliance issues

NO USE TAX REMITTED

Questions/Comments

Diane Yetter
Sales Tax Institute
diane@salestaxinstitute.com
(312) 701-1800, ext. 2

Thanks to our Sponsors!

SOVOS
Compliance

R&M R&M **CONSULTING**
Known by heart.

Avalara

Thank you for watching!



[@SalesTaxInst](https://twitter.com/SalesTaxInst)



[/company/sales-tax-institute](https://www.linkedin.com/company/sales-tax-institute)



[/user/salestaxinstitute](https://www.youtube.com/user/salestaxinstitute)



[/salestaxinstitute/](https://www.facebook.com/salestaxinstitute/)

Sales Tax Institute

910 W. Van Buren, Suite 100-321

Chicago, IL 60607

(312) 701-1800

webinars@salestaxinstitute.com