

Sales Tax 101



SALES TAX
INSTITUTESM

On-Demand Webinar



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- Accounting Today's 100 Most Influential People in Accounting for 7 times between 2011 and 2021
- Woman Business Owner of the Year 2020

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

- 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

- 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

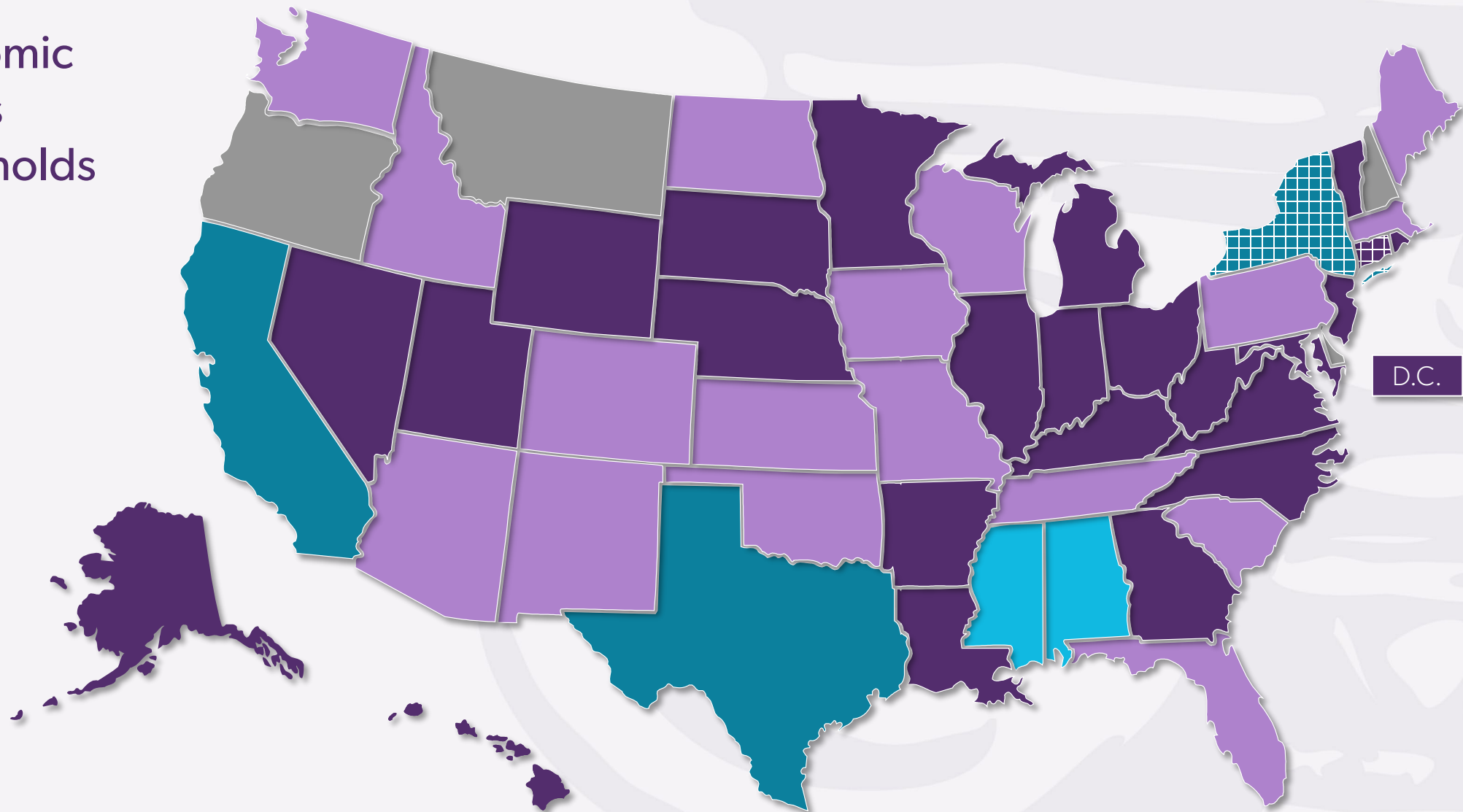
Nexus – Economic

- **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

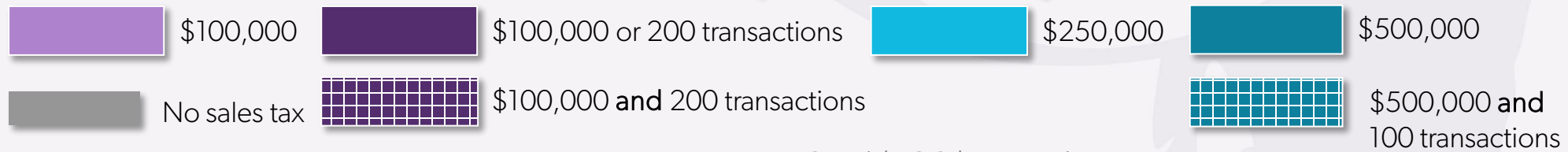
Nexus – Economic (cont.)

- *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

Economic Nexus Thresholds



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Economic Nexus - Definitions

- Threshold: The amount of sales and/or number of transactions (invoices) that determine when you have substantial nexus in the state.
 - The threshold may be dollar only or dollar with transaction count
 - Increasing trend among states to not include or to remove the transaction count from the threshold

Economic Nexus - Definitions

- Includable Sales: The specific sales to include when determining if you meet the economic nexus threshold.
 - Gross Sales (most typically used)
 - Retail Sales (excludes sales for resale)
 - Taxable Sales (excludes all exempt sales)
 - Marketplace sales may be included or excluded when calculating the threshold for individual sellers, depending on the state.
 - Do you include freight?
 - Do you deduct selling fees? (e.g. Amazon sellers)

Economic Nexus - Definitions

- Measurement Date: The time period for determining the amount of sales and/or number of transactions.
 - Typically the current or previous calendar year (most states), however some states have a different measurement date.
 - Previous calendar year (Alabama)
 - Preceding 12-month period (Illinois)
 - The 12-month period ending on the last day of the most recently completed calendar quarter (Minnesota)
 - Immediately preceding four sales tax quarters (New York)

Economic Nexus - Definitions

- When You Need to Register Once You Exceed the Threshold:
How soon you need to register to collect and remit sales tax once the threshold is met.
 - Next transaction (per state guidance)
 - Next transaction (state doesn't specify)
 - Delayed
 - Example: 60 days after a remote seller meets the threshold (Minnesota)
 - Example: The first day of the month that starts at least 30 days after you meet the threshold (Washington)

Economic Nexus Chart

- Sales Tax Institute Economic Nexus Chart:
<https://www.salestaxinstitute.com/resources/economic-nexus-state-guide>

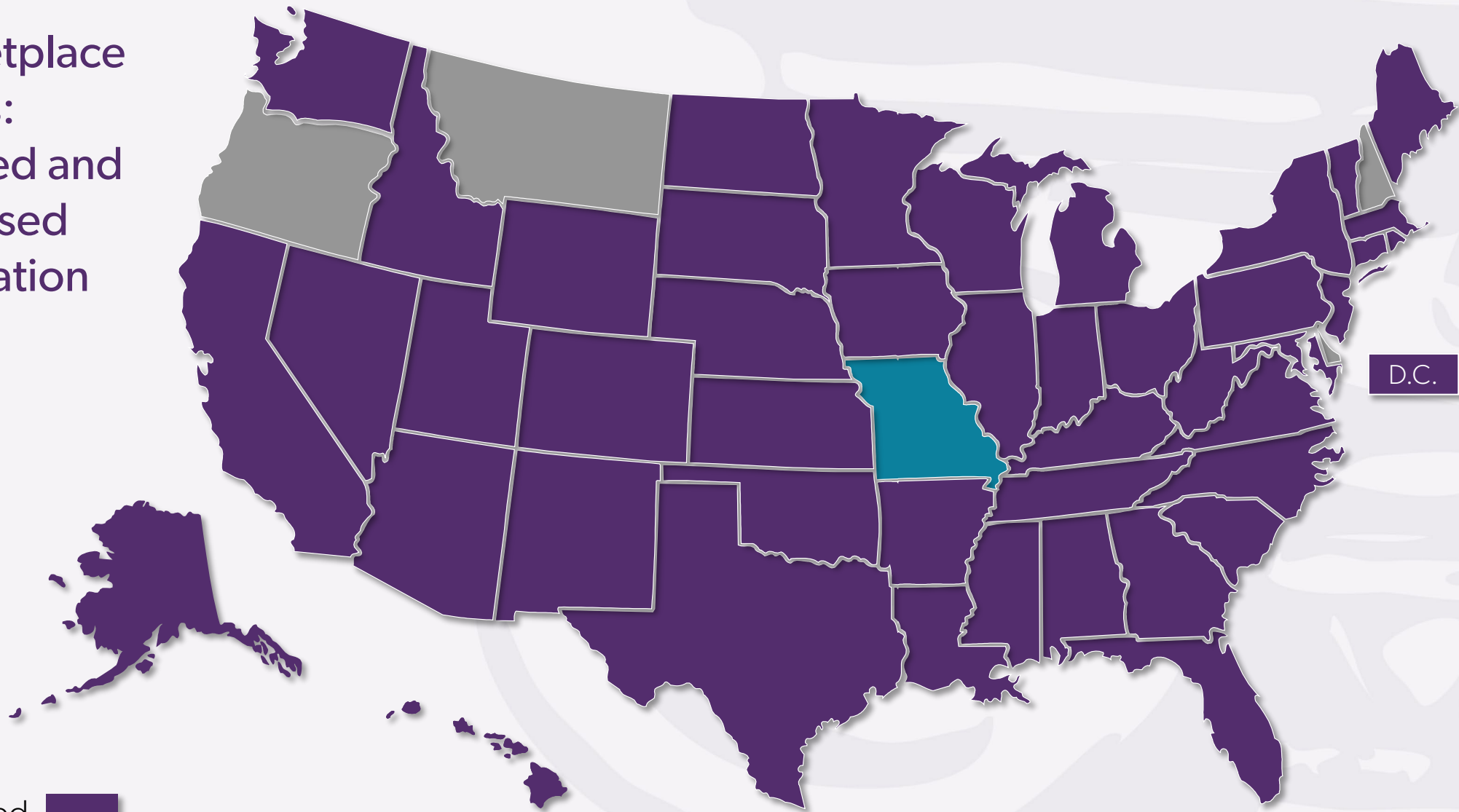
Nexus – Remote Seller (cont.)




- **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

Marketplace Nexus

- 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

Marketplace Nexus: Enacted and Proposed Legislation



Enacted 
No sales tax 
Effective January 1, 2023 

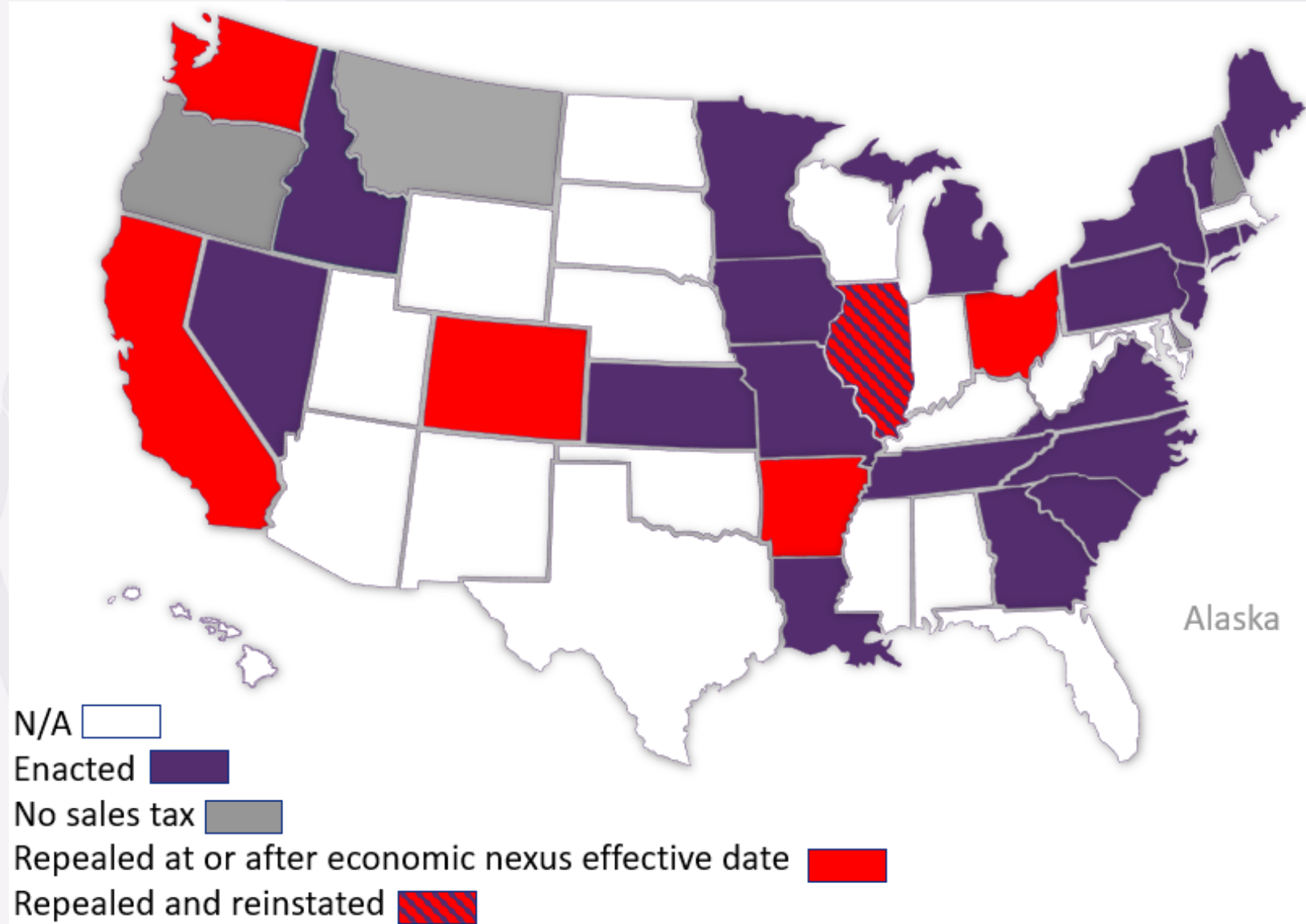
Marketplace Nexus

- MTC Workgroup (<https://bit.ly/2SYvQAH>)
- SST Workgroup 2019-08 Marketplace Facilitators & Sellers (<https://bit.ly/3mZC7Iz>)
- SST Disclosed Practice 8 (<https://bit.ly/3moYZaQ>)
- NCSL Model Code (<https://bit.ly/3ofBZuU>)

Nexus – Remote Seller (cont.)

- **Click-Through Nexus** can be established through the payment of commissions for successful completion of an order through a referral mechanism

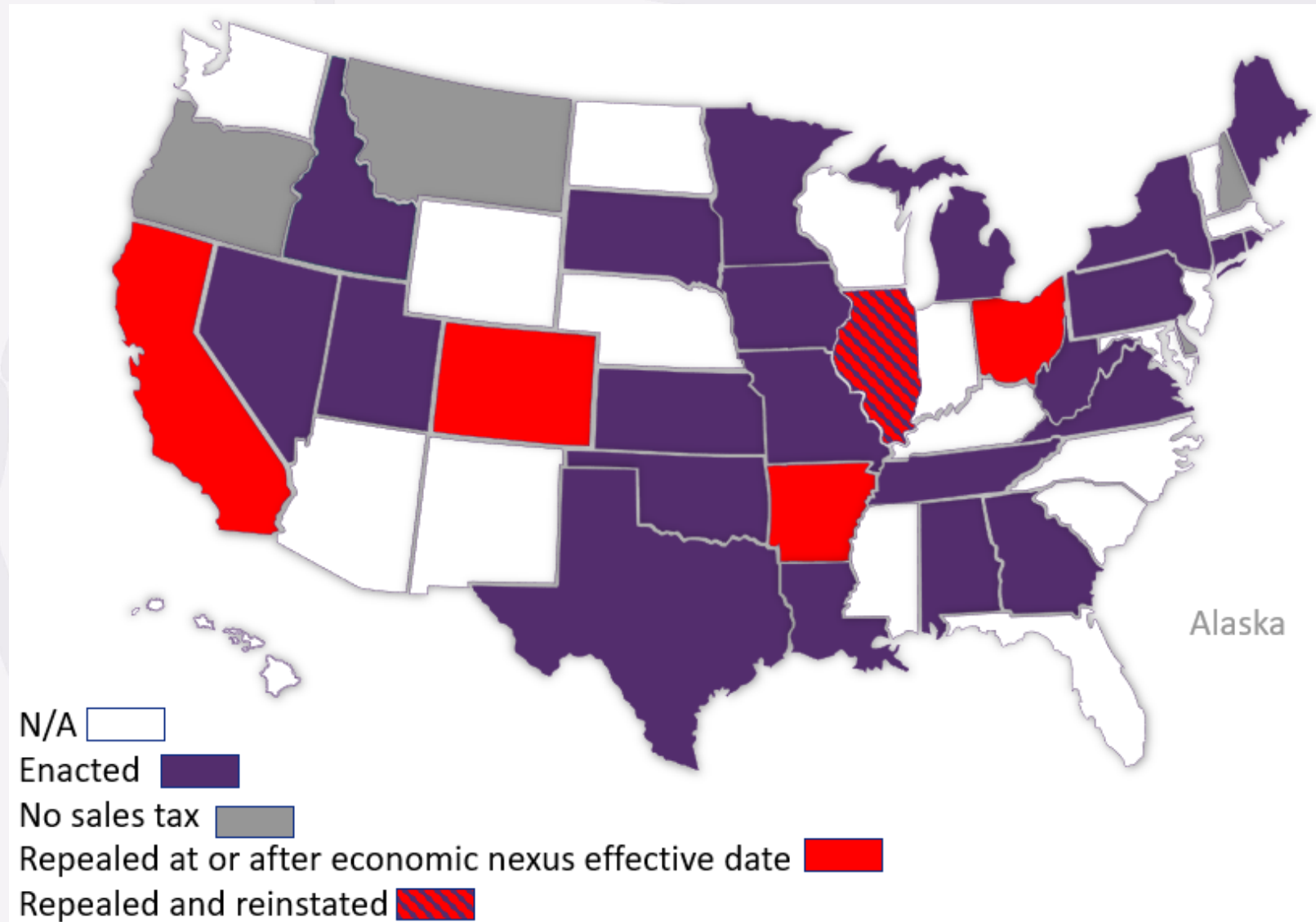
Click-Through Nexus: Enacted and Proposed Legislation



Nexus – Remote Seller (cont.)

- **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

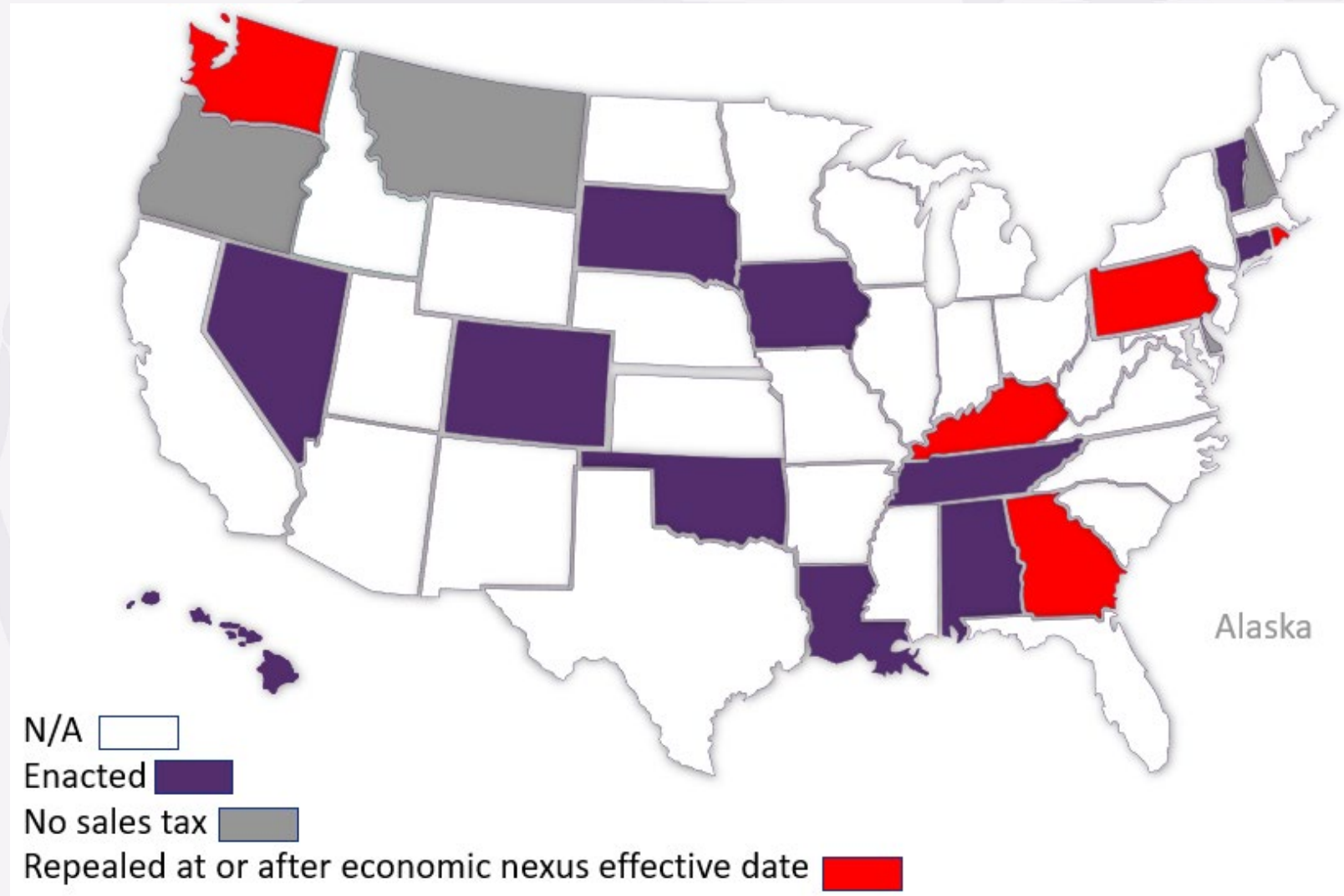
➤ Affiliate Nexus: Enacted and Proposed Legislation



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

➤ Reporting Requirements: Enacted and Proposed Legislation



Nexus – Remote Seller (cont.)

- Sales Tax Institute Remote Seller Nexus Chart:
<https://www.salestaxinstitute.com/resources/remote-seller-nexus-chart>



Exemptions

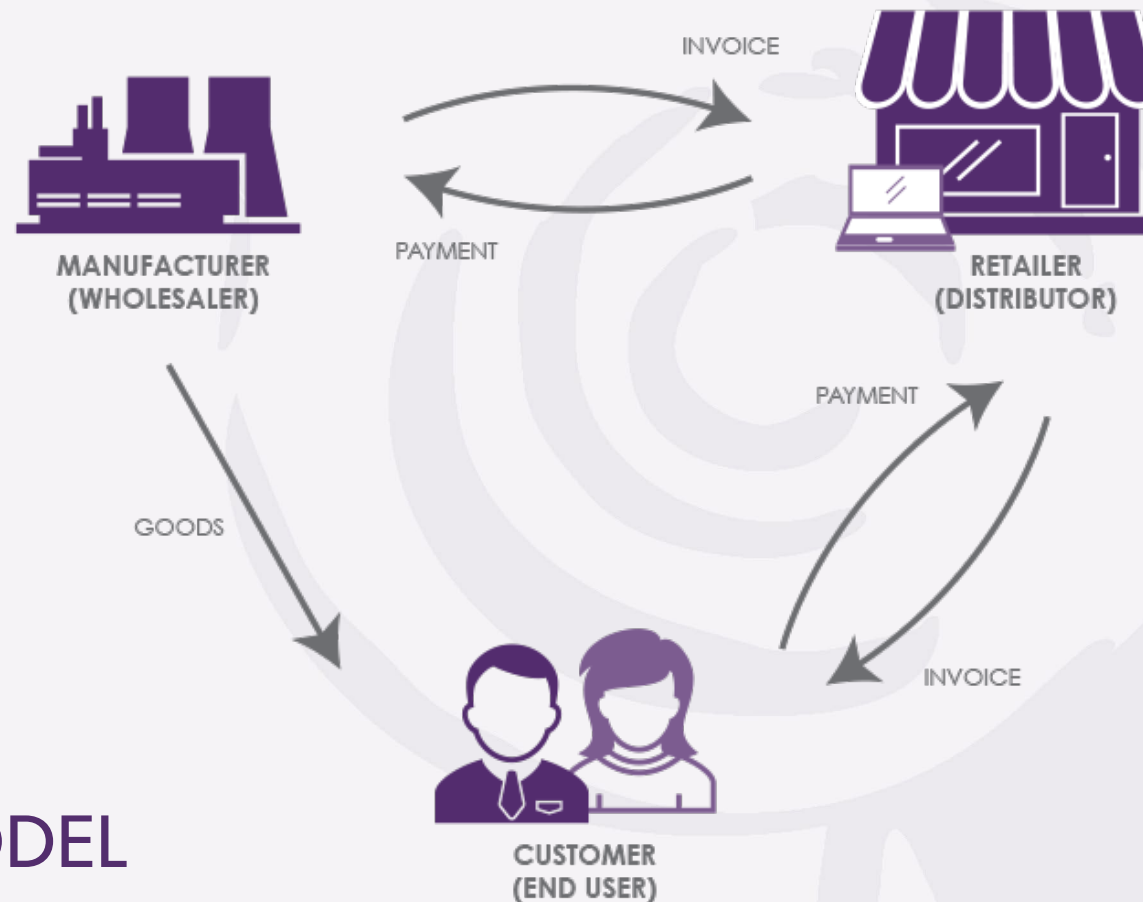
Exemptions

- 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> (*updated as of June 21, 2022*)
 - SST Form: <https://www.streamlinedsalestax.org/Shared-Pages/exemptions> (*Revised December 21, 2021*)
- Originals
- Expiration



Industry Issues

Software

- Software poses challenges in taxation due to nature of delivery and related services
 - Canned Software delivered tangibly is almost 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 broadly tax services
 - South Dakota
 - New Mexico
 - Hawaii
 - West Virginia

The background is a solid teal color with faint, stylized botanical illustrations in a slightly darker shade of teal. These include a large, prominent flower or leaf pattern in the center and other smaller, more delicate floral motifs scattered around, particularly on the right side.

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?
- When did you enter the jurisdiction?
- How often will you have to file?

Registration Considerations

- Obtain exemption certificates
- Statute of Limitations issues
- 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 (food/drug predominately)
- 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

Differences Between States & Localities (cont.)

- Alaska
 - Remote Seller Sales Tax Commission (<https://arsstc.org/>)
 - Nexus is determined at state level and then collect for all participating locals
 - If physical presence, register with that locality but others under Remote Seller

Differences Between States & Localities (cont.)

- Colorado
 - Sales & Use Tax System (SUTS): <https://tax.colorado.gov/SUTS-info>
 - Centralized system for remitting state-administered and some home rule authorities
 - Home rule authorities are not required to participate
- Louisiana
 - Sales and Use Tax Commission for Remote Sellers <https://remotesellers.louisiana.gov/>
 - Single registration and remittance
 - Collect all actual home rule taxes at full rates and following local taxability rules
 - Can not participate if any physical presence in the state

Differences Between States & Localities (cont.)

- Alabama
 - Simplified Seller's Use Tax (SSUT)
 - Collect a flat rate of 8% and remit to state
 - Must be a remote seller to qualify and apply
 - Amazon inventory won't disqualify
- Texas
 - Single Local Use Tax Rate (currently 1.75%)
 - An alternative local tax rate that remote sellers can use instead of collecting and remitting the total local tax in effect at the destination address.
 - Remote sellers can choose to collect the single local use tax rate.
 - If you have any physical presence in Texas cannot use the rate.
 - Remote sellers must notify the Comptroller that they're electing to use the single local use tax rate.

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

Sourcing of Sales Tax (cont.)

- New Mexico
 - Effective July 1, 2021, New Mexico changed the sourcing requirements for all sellers to destination.
 - For remote sellers this results in the requirement to collect the sales tax and not the use tax.

Sourcing of Sales Tax (cont.)

- Illinois
 - Effective January 1, 2021, Illinois changed the sourcing requirements for remote sellers to destination under its Leveling the Playing Field provisions.
 - For remote sellers this results in the requirement to collect the sales tax and not the use tax.

Return Preparation

- File on a timely basis
- Generally due in the month following the taxable event
- Due dates vary by jurisdiction (15th, 20th, 25th, EOM)
- Prepayments
- Vendor discounts
- Electronic filing
- EFT

Questions & Comments

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Thank you for attending!



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