

Feature

## Rising Complexity In Sales Tax Compliance Drives Up Burden

By [Matthew Nesto](#) · June 6, 2018, 8:54 PM EDT

No matter how the [U.S. Supreme Court](#) rules in the closely watched South Dakota v. [Wayfair](#) case, tax pros say the cost and burden of complying with sales tax jurisdictions in 45 states and more than 10,000 localities is not likely to get easier anytime soon.



The U.S. Supreme Court heard oral arguments in Wayfair in April. (Law360)

Despite efforts by industry groups, accounting firms and regulatory agencies to curtail complexity, experts say the problem has festered and grown for years, causing a tax drag on business and the economy that is too big to ignore.

“The U.S. sales tax is one of the most complex and inefficient consumption taxes in the world,” proclaimed a slide from a presentation this week at the Federation of Tax Administrators annual conference in Nashville, Tennessee.

According to Karl Frieden, general counsel for the Council on State Taxation, at least three key areas of complexity stand out.

“Unlike most industrialized countries in the world, the design in the U.S. of taxing business inputs makes things extremely inefficient,” Frieden said, noting that 42 percent of total sales tax revenue comes from the taxation of business inputs, which carries the pyramid effect of a redundant tax.

Frieden also notes that two-thirds of Americans live in states that have not signed on to the Streamlined Sales and Use Tax Agreement. Even though 24 states have adopted the simplification standards, Frieden said, the fact that the six largest states have not diminishes its benefit.

Likewise, most states offer little or no compensation to reimburse vendors for the cost of collecting, remitting or refunding sales tax, another driver of expense Frieden highlights, pointing to a PwC study from 2006 that showed tax compliance costs range from 2 percent for large businesses to more than 13 percent for smaller establishments.

It's gotten to the point, experts say, that even the best-intentioned businesses still get tangled up in this web of complexities.

According to Diane Yetter, veteran accountant and founder of the Sales Tax Institute, no amount of software, filing systems or reporting records will help if the product classifications are wrong.

"The first step is to be clear about and understand what it is that you're buying or selling," Yetter said. "You have to understand the nuance, specifications and minutiae before you even get into the tax law."

For example, Yetter said a client that makes energy bars would first have to determine if the product contains flour, which in most cases would qualify it — and make it tax exempt — as food. But if it doesn't contain flour, then the bars would likely be considered candy, although just to complicate things, many jurisdictions don't treat candy as food.

Another potential pitfall Yetter cited includes determining whether an extended warranty was actually a service contract, whether or not its price was included in the underlying purchase, and whether it was optional or mandatory.

Her point was that determining the proper tax rate to charge and remit to a state or local authority is complex and that small, often innocent mistakes can carry large and costly consequences.

“What’s making things even more complicated is new technologies, new business models, how people are selling things, how they’re delivered in intangible ways,” Yetter said, “and a lot of states have not kept up.”

While experts say technology has made some back-end parts of the process easier, including filing returns or applying the correct rate in multiple jurisdictions, the process is far from easy.

“Technology has made it easier to comply, but it’s still not easy,” Frieden said, “and the burdens are still there.”

It’s a problem that is especially costly for online retailers.

“Sales tax for e-commerce sellers is much more difficult than it is for brick-and-mortar,” said Jennifer Dunn at TaxJar, which sells sales tax automation products. While brick-and-mortar stores typically must deal with just one sales tax rate and one set of state laws, most e-commerce sellers have to contend with multiple states, laws and rates, as well as a mix of product rules and definitions, and different filing frequencies and due dates.

“It’s unclear that lawmakers understand how difficult dealing with sales tax in the U.S. truly is,” Dunn said in an October 2017 blog post in which she called the current system fragmented, complicated and full of pitfalls.

It’s also unclear whether the Supreme Court in *Wayfair* will overturn *Quill*, the 1992 decision that reaffirmed the physical presence standard for taxation, but even if it does, most tax pros foresee at least an initial surge in compliance-related activity that would burden businesses and taxing agencies alike.

As much as a high court decision will at least bring closure to the constitutional argument, it will do little toward constructing an “efficient and fair modern-day sales tax system,” Frieden said. In fact, in some ways, it could make things worse.

“If Quill is flipped, that pressure of the past 25 years that has lead to streamlining and so much more might actually dissipate,” Frieden said.

--Editing by Robert Rudinger and Tim Ruel.

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