5 Ways Growing Companies Get Tripped Up by Sales Tax

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 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 and even to the taxing authorities that enforce them.

Before the ecommerce boom, sales tax didn't make the headlines 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 Unites States ruled in Quill Corp. v. North Dakota (Quill) 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: 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 do.

Losses from uncollected tax on remote sales, combined with outdated and inadequate federal legislation, led states to take another tack: expanding the definition of nexus to include a much wider range of activities – many of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, on June 21, 2018, a landmark decision in South Dakota v. Wayfair, Inc. (Wayfair), essentially killed Quill. In its decision, the Supreme Court concluded that

DID YOU KNOW?

There are 12,000 tax jurisdictions in the U.S.

South Dakota has 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 the Wayfair ruling, dozens of states scrambled to pass economic nexus laws of their own. To date, 43 of the 45 states with a sales tax have economic nexus policies in place or will have by the close of 2019.

For more info, check out Avalara's 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 roadblock 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 5+ states, sales tax gets exponentially more complicated as rates, rules, and filing requirements can vary greatly 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 US 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, which can add greatly to business expansion costs. An automated cross-border tax compliance solution may well be worth considering if your growth plans extend overseas.

DID YOU KNOW?

43 states now require remote sellers to collect sales tax and 36 states have marketplace facilitator laws related to ecommerce selling.

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 you – and for the states. Forty-three of the 45 US states with sales tax now require remote sellers to collect sales tax on ecommerce transactions. Additionally, 36 states have laws requiring marketplace facilitators to collect sales tax on behalf of their sellers. In some states, participating in affiliate programs or online advertising is enough to create that connection; 33 states have affiliate nexus and 22 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.

DID YOU KNOW?

If you sell products and services, you must break out product and services separately on invoices to avoid the state viewing the entire transaction as taxable, even if a portion is exempt.

3. **Adding products or services.** Growth-driven companies are always innovating, looking for ways to break into new markets or reach more customers. However, 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 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 instance, 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, 17 states impose sales tax on software as a service and 26 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

DID YOU
••• KNOW? •••

If you're obligated to collect sales tax in a state, then you have to file there too.

DID YOU
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Growth affects how companies are picked and chosen for audits. So don't be surprised if you get hit with multiple state audit notices.

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 very 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'll need to 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 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 makes your compliance picture exponentially more complex, 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 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 24 participating states.

5. **Gaining a high public profile.** Congratulations, your company's making headlines! The journey from start-up to industry giant often happens quickly, but rarely quietly. Idea-to-IPO success stories stud 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 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 lax. One costly sales and use tax audit could spell major problems, especially if you are anticipating a liquidity event.

Compliance problems 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

Avalara's end-to-end sales tax compliance solution scales with your company at every phase of growth, from the home office to the Fortune 500. Avalara's industryleading tax calculation engine is lightning-fast, returning sales tax calculations in an average of just .0651 seconds. Our cloud-native solutions update your tax records in real-time so there's no updates to make and no question that you're in compliance. You can feel confident that every jurisdiction, every rate, every regulation is accurate and accounted for. Avalara's expertise in sales tax is so deep that we offer the industry's first-ever [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.

Pre-built integrations mean that you can get better 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 700+ solution partners) means that even when you change software, you can keep the fast, accurate calculation you've grown to trust from Avalara.

Don't wait until you've outgrown your current system to get compliant with sales and use tax regulations. Do it right the first time, with a solution that scales with you – wherever you grow. Visit www.avalara.com today for more information on how Avalara can make compliance easier for your high-growth business.

Why are states so aggressive with sales tax compliance?

Even though they add just a small percentage to purchase prices, the combination of general sales taxes (applied to most transactions) and selective taxes (levied on transactions like hotel room rentals or alcohol purchases) account for a whopping 47 percent of state revenue, according to the U.S. Census Bureau. To put that total in perspective, state income tax only accounts for 35 percent of state revenue.

It's easy to see why states have started looking more and more toward sales tax auditors to help with revenue shortfalls. Politicians would rather enforce existing tax collection laws than face scrutiny for raising taxes, so this is a trend that is likely to continue.

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