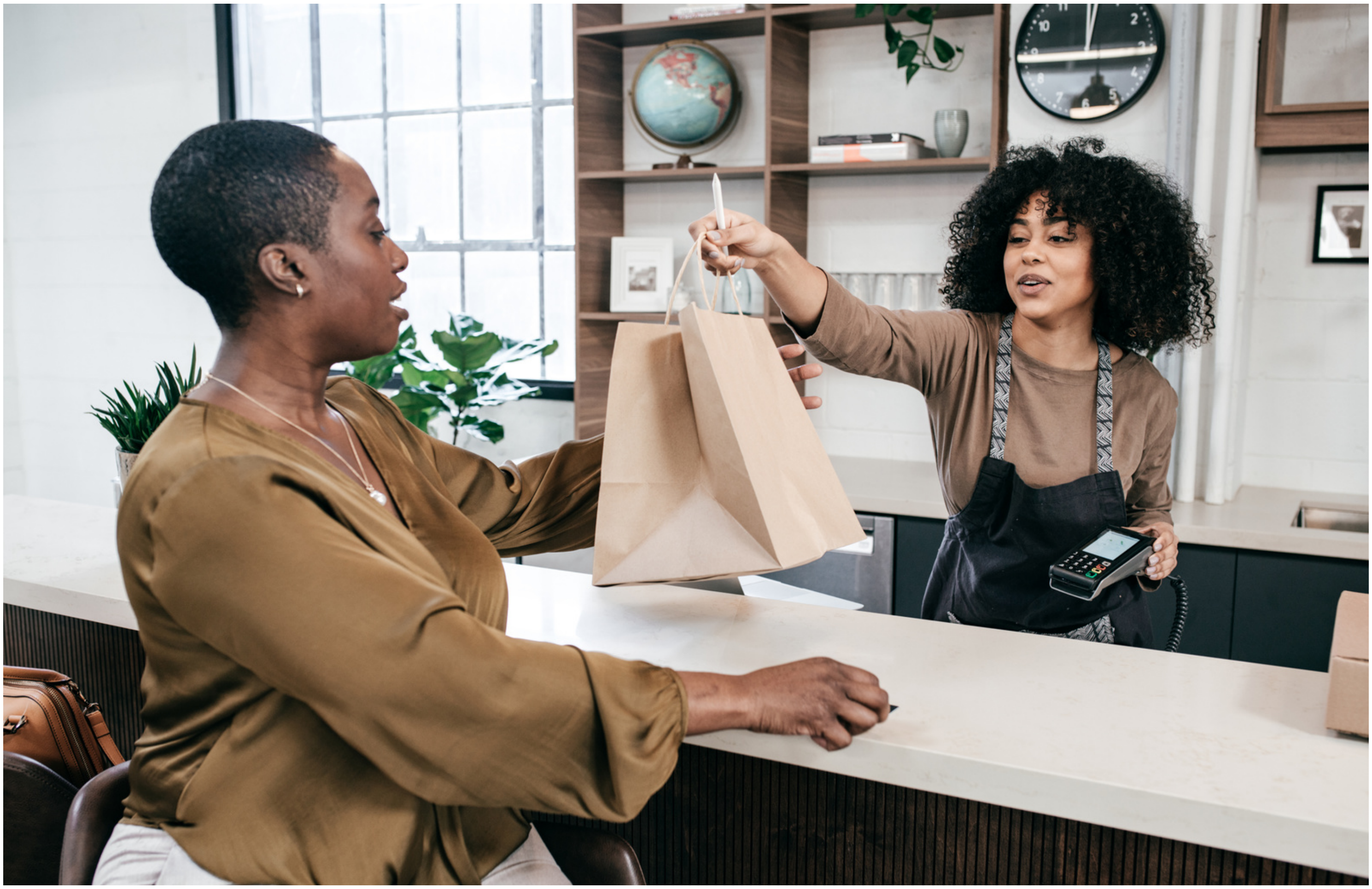
A guide to:

Understanding sales and use tax

Wolters Kluwer



This guide is meant for anyone whose business must collect sales and use taxes to better understand how the overall process works, and why it's so important that we all participate conscientiously to ensure proper taxes are charged, collected, and paid.

Whether as a business person or a consumer, everyone is involved with sales and use taxes. As consumers, we pay them on many of the purchases we make. As business people, we collect them on behalf of several tax authorities and then remit them periodically.

In this guide, we'll discuss the sales and use tax issues that affect your business on a daily basis. We'll also look at the changing landscape of out-of-area or interstate sales, which is essential to any rapidly growing number of sellers serving customers in areas other than their own. The rules have changed recently, and they've changed significantly. You must understand how to manage this properly to avoid paying non-compliance fines and penalties, which can become substantial.

We'll also discuss typical audit issues and help you understand what auditors look at so you can better prepare.

Questions? Please contact us at SalesCorporateTeam@WoltersKluwer.com, or 800-739-9998 so we may answer them.

Sales taxes provide the highest proportion of most state's total income, the funds they use to manage services, operate the government and fulfill all the state's responsibilities placed on each state.

Who actually charges sales tax?

The popular misconception is that the federal government charges sales tax. Sales tax may be charged by any of the states, counties, cities, districts, and any combination, but it is not charged by the federal government. Making this more confusing, the levels charged in various areas may not align with the geopolitical boundaries you would assume, such as Zip Code areas. It can often be very difficult to know what to charge based on where you or your customers are located.

Why are sales taxes charged?

Sales taxes are an important source of revenue for state and local governments, with rates varying widely from state to state. In some states, sales taxes can be as high as 10%, while in others they are much lower. Additionally, some states exempt certain types of goods and services from sales taxes, such as groceries or prescription drugs.

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What are sales taxes charged for?

In general, state sales tax is imposed on tangible personal property (TTP), things that can be seen, weighed, smelled, tasted, or touched; something that's perceptible to the senses. Telecommunications services, digital data, or electronic content can sometimes be considered TTP, with the interpretation varying from state to state. One example of a taxable digital service is the downloading of software. Exemptions can be state-specific and can differ from state to state, which makes having a reliable tax platform is essential to offer the most current exemption certificate management.

Services can be treated as exempt in many states, however, some states specifically list services for which tax is charged. For example, Professional Services are not taxed by most states with the outliers being South Dakota, Hawaii, and New Mexico. It's important to find out and understand how your state treats exempt services and what they deem to be a taxable service.

What about sales outside my state?

Prior to 2018, you would only collect tax for any state in which you had some physical facilities such as warehouses or offices. Having a physical presence in any state was the qualifier for having achieved what tax experts refer to as nexus.

In 2018, the state of South Dakota saw that online reseller Wayfair was selling a high volume of products into their state. Since Wayfair had no physical presence there, they were not required to collect or remit sales tax. Feeling this was unfair to their state and their citizens, South Dakota sued Wayfair. As a result of this lawsuit, the requirements for achieving nexus in each state were changed. No longer did you need a physical presence. Instead, they established rules for an economic presence sufficient to achieve nexus. Now, when a seller exceeds a specified volume of sales or sells to a number of different customers exceeding a set threshold, they achieve nexus; which defines the connection between the state taxing authority and your business.

There are a few things that are important to note here, the first of which is that any seller achieving nexus in a state would be required to register to sell in that state. They would also need to carefully track their sales to make sure they knew when they had exceeded either the sales volume or the number of unique customers threshold. Most states will issue warrants and levy fines on the very next sales after a company achieves nexus, and they are watching very carefully.

Making this just a little more complex is the fact that the thresholds in every state are different. They are based either on transactions or sales volume, and it's not too difficult for even small sellers to achieve nexus in multiple states. If you're among the many who continue to flock to eCommerce, be forewarned there is now much more homework to be done before you begin. If you've understood the change from physical nexus to economic nexus then hold on, because there are also several alternative nexus approaches some states use. There's a Click-Through Nexus created when an individual business provides the link to another website. Attributional Nexus is created via a relationship between an out-ofstate retailer and an in-state affiliate, forming an agency-like behavior.

Then there's Cookie Nexus, not a tax on late-night snacks, but cookies that are read on a computer. When you visit a vendor's website, and your computer downloads this cookie or app, that can create nexus. There's an Online Marketplace Provider's Nexus which may apply when you use Amazon or other online marketplaces. Then there's the customer information reporting and notice requirements nexus which applies when the seller doesn't collect sales or use tax and the buyer is required to report the purchase on their personal income tax return.

If you think nexus rules don't apply to you, stop and think again. Investigate. And if you find that you do have liability, don't wait for the state to find you. They will. They'll continue sending out huge questionnaires, jeopardy assessments, and worse. Register and become compliant wherever you are not. Ask your tax expert if you should issue a voluntary disclosure agreement (VDA) to acknowledge your error and begin making reparations from a proactive position.

It often takes a tax lawyer to really understand much of this and to accurately interpret all the tax statutes to properly assess taxability. Where is it being sold, what are the nexus rules there, understanding where the nexus applies, what the thresholds are, what the effective dates are, and then managing the sales tax for your customers. One of the leading causes of inflated audits is incorrect assumptions.

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What is the difference between sales and use tax?

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Sales tax is collected by the seller from the purchaser. When you go into a store and buy something, you’re charged the sales tax along with the price when the sale is transacted.

Use tax, or consumer’s use tax is paid by the seller though they do not collect it from the buyer. There’s also a seller’s or retailer’s use tax that must be collected by an out-of-state seller who has achieved nexus in the state in which the sale actually takes place.

For example, sales tax is when you buy an item and are charged a separate tax — most consumers are used to this tax. Use tax is when you buy an item wholesale tax-free and then pay to use it.

Preparing for the inevitable — you are going to be audited

It’s not a question of if, it’s a question of when. The best strategy for passing an audit is to do your own internal audit first. Take the time to find your exposures, the rights, and remedies available in the state that can audit you; and remember it may no longer be just your own state.

Be prepared. Check the auditor’s work and come equipped with answers. You have every right to defend your actions when questioned.

Audit issues to prepare for

With the new nexus rules, the easiest place for you to go astray inadvertently is in not taxing transactions in a jurisdiction in which you have achieved nexus. With the overwhelming mix of misaligned boundaries, varying thresholds, and constant new introductions of new nexus rules it is all too easy to miss on some transactions. An important exercise is to investigate every transaction in which you did not charge tax to assure that you were correct in doing so.

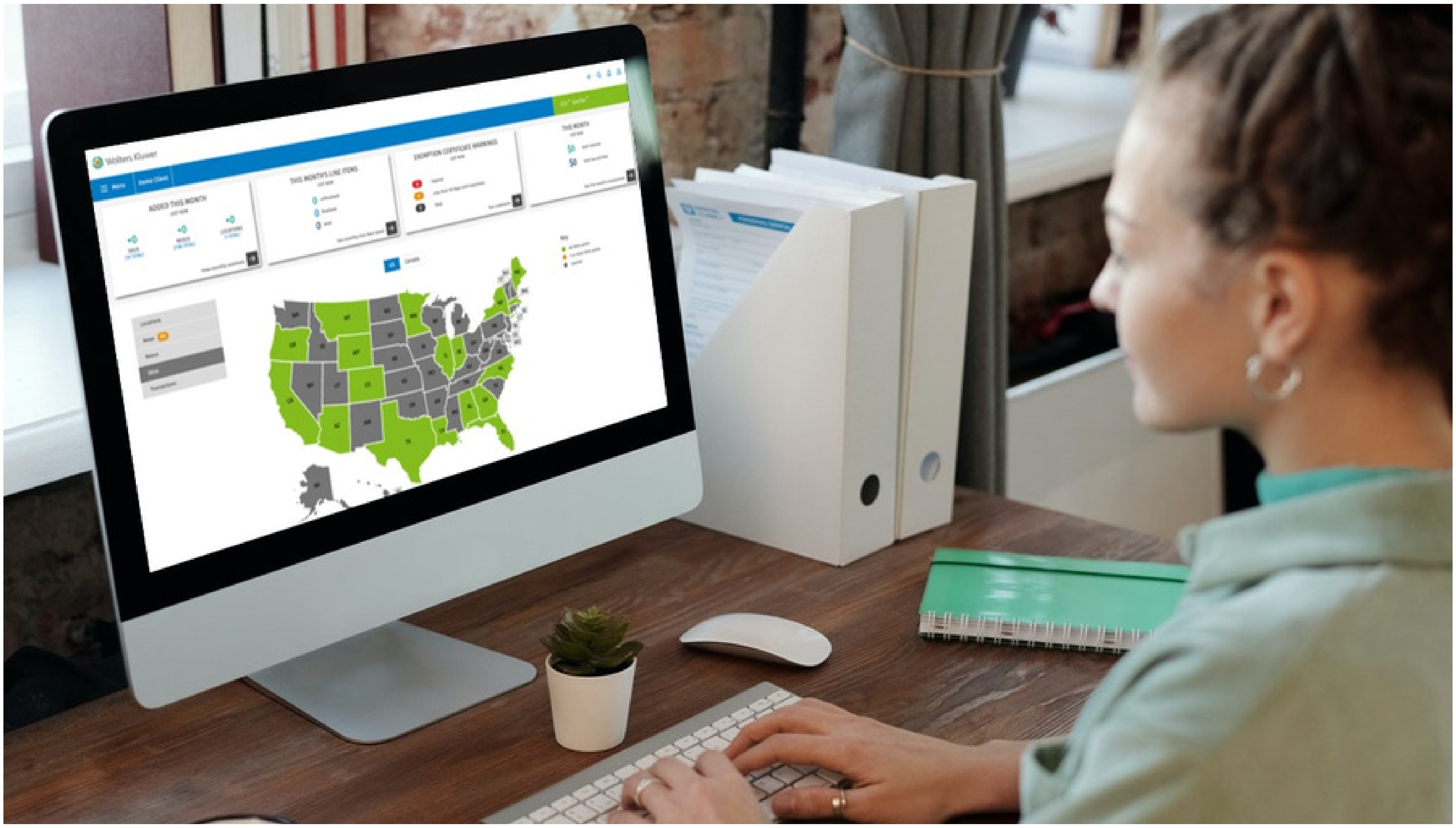
Use tax can also trip you up. Have you properly assessed and declared your fixed assets? Your operating expenses? Have you confirmed that you can handle the taxation of drop shipments properly? Have you been exempting all the right items and services? Always know how much 2% of your revenue is. Audits can lead to fines of up to 2% of revenue. Know your exposure.

Think automation — it may be time to digitally transform your tax workflow management

Opportunities may drive you to achieve nexus before you’re ready. Often, the ERP system you’re using to run your business is designed to manage local tax tables only and has no provisions for multi jurisdiction taxation. In most cases, you can add an external taxation engine to take over these key calculations without having to undergo the pain of changing from one ERP to another. Also, these engines are always updated with the latest rates and rules for every jurisdiction.

You need to upgrade your systems and your taxation workflow are being driven by growth. This is good news. Celebrate this while you practice the diligence necessary to assure you remain in compliance with all the tax jurisdictions in which you transact business.

Remember that automation not only accelerates your processes, it reduces your error rate too.



Reinforce your sales and use tax calculation with the most accurate rates and rules data in-class

CCH® SureTax®

The end-to-end cloud-based sales and use tax automation platform that assures your business accurately calculates, collects, and remits taxes to correct authorities, every time. This scalable solution supports your sales and use tax determination needs at every stage of your business growth. CCH® SureTax® is a modular solution and offers:

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- Calculation
- Exemption Certificate Management
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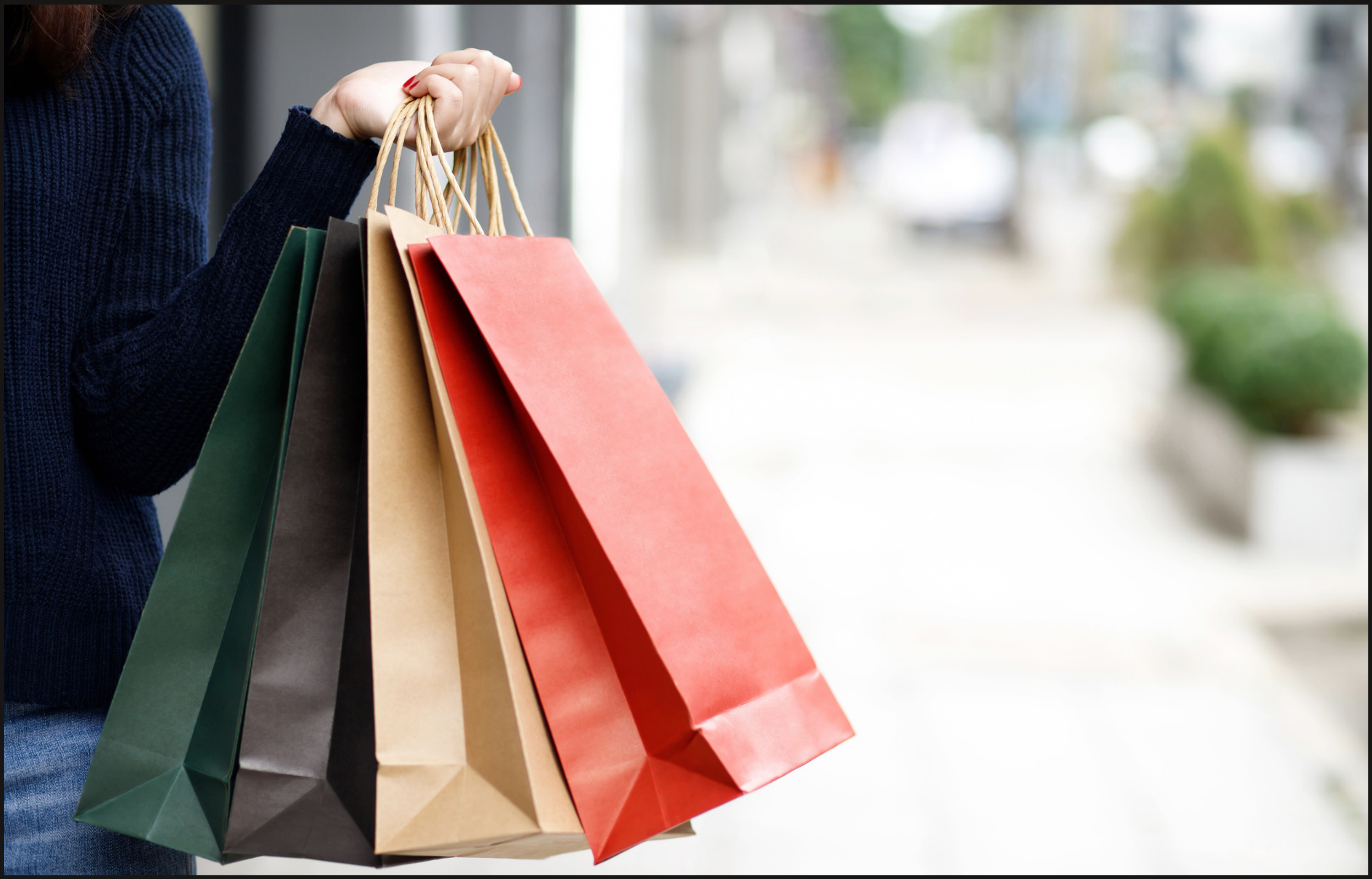
CCH® Sales Tax RADAR

The most advanced browser-based sales and use tax rates and taxability lookup tool, where data is offered with great detail and trusted by the IRS for over 15 years. The modular-based subscription model allows you to pay for only what you need. CCH® Sales Tax RADAR is the best solution for small companies with a limited range of products or geographies.

CCH® Sales Tax Rates and Taxability Databases

This solution provides the industry's most comprehensive database of taxability rules — thoroughly researched and expertly maintained. Whether your company is looking for data to feed into your home-grown billing system or commonly used ERPs, this product lets you simply map your product code to the appropriate tax category and be accurate on taxes at all times without any hiccups.



Contact information:
Wolters Kluwer 2700 Lake Cook
Road Riverwoods, IL 60015
United States
800-739-9998, Option 1

For more information, email us at CCH
SalesCorporateTeam@WoltersKluwer.com

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