LEARNING MADE EASY

Avalara 2nd Special Edition

Sales & Use Tax Compliance

for dummies®
A Wiley Brand

Comply with sales and use tax regulations

Determine nexus and what it means

Better manage reseller certificates

Brought to you by

Avalara

Elaine Marmel

About Avalara

Avalara helps businesses of all sizes get tax compliance right. In partnership with leading ERP, accounting, e-commerce, and other financial management system providers, Avalara delivers cloud-based compliance solutions for various transaction taxes, including sales and use, VAT, excise, communications, and other indirect tax types. Headquartered in Seattle, Avalara has offices across the U.S. and around the world in the U.K., Belgium, Brazil, and India. More information at **www.avalara.com.**

Sales & Use Tax Compliance

Avalara 2nd Special Edition

by Elaine Marmel

for dummies®
A Wiley Brand

Sales & Use Tax Compliance For Dummies®, Avalara 2nd Special Edition

Published by
John Wiley & Sons, Inc.
111 River St.
Hoboken, NJ 07030-5774
www.wiley.com

ISBN 978-1-119-58063-8 (pbk); ISBN 978-1-119-58130-7 (ebk)

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1

For general information on our other products and services, or how to create a custom *For Dummies* book for your business or organization, please contact our Business Development Department in the U.S. at 877-409-4177, contact info@dummies.biz, or visit www.wiley.com/go/custompub. For information about licensing the *For Dummies* brand for products or services, contact BrandedRights&Licenses@Wiley.com.

Publisher's Acknowledgments

Some of the people who helped bring this book to market include the following:

Development Editor: Elizabeth Kuball

Copy Editor: Elizabeth Kuball

Executive Editor: Amy Fandrei

Editorial Manager: Rev Mengle

Business Development Representative: Karen Hattan

Production Editor: Magesh Elangovan

Table of Contents

Introduction

Most U.S.-based businesses have some sales tax liability and often also use tax liability. And, contrary to popular belief, your business doesn't need to be a retail business to incur the liabilities for these taxes.

If you do business outside the United States, you may have additional sales tax requirements. The rules in the U.S. are complicated enough that this book focuses just on those and doesn't consider rules of taxing authorities outside the United States.

Okay, so, you're ready to comply with sales and use tax regulations . . . if you could just figure them out. They've always been complicated, and, in recent years, with states trying to increase their revenues, the rules have gotten even more complex.

Although it might seem overwhelming and hopeless, it's not yet time to throw up your hands in despair! You have options, and this book helps you explore them.

About This Book

Sales & Use Tax Compliance For Dummies, Avalara 2nd Special Edition, explores ways to effectively manage complying with the growing complexity of sales and use tax regulations.

This book is aimed at financial management professionals who want to explore ways to comply with sales and use tax regulations.

Use the information in this book to learn about *nexus* (the obligation to collect and remit tax). Examine the sales and use tax landscape in today's economy, how well your business complies with sales and use tax regulatory requirements, and how to avoid sales and use tax audits, which can be far costlier than you may expect.

One note on this revised edition: On June 21, 2018, the Supreme Court of the United States ruled in favor of the state in *South Dakota* v. *Wayfair, Inc.,* concluding that 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. This is called *economic nexus*, and it virtually puts an end to tax-free online shopping as we know it.

Since *Wayfair*, 28 states have economic nexus laws and more are likely to follow. That means that if your business sells into these states — via the Internet, catalog sales, or cross-border delivery of taxable goods and services — you could have to register to collect and remit sales tax in one or more of them. Of course, you still have a sales tax obligation in states where you have physical presence nexus.

I cover economic nexus in more detail in Chapters 1 and 2 of this revised edition.

Icons Used in This Book

Throughout this book, special icons appear occasionally to call attention to important information. These icons won't wink at you, but they help you identify information you definitely want to note. Here's what you can expect:

REMEMBER

The Remember icon points out juicy morsels of information that may be repeatedly useful to you.

TIP

The information marked by the Tip icon offers advice or a bit more information about a topic under discussion.

WARNING

The Warning icon warns you of mistakes that can cost money and how to avoid them.

Beyond the Book

I can cover only so much information about sales tax in 48 pages. However, the good folks at Avalara have lots more information they'd like to share with you. So, feel free to visit `www.avalara.com`.

IN THIS CHAPTER

» **Defining nexus**

» **Understanding sales tax and use tax**

» **Considering the supply chain**

» **Understanding the role of exemption certificates**

Chapter 1
Understanding the Sales Tax Landscape Today

Smart, successful businesses are always looking for ways to increase profits by increasing sales or reducing costs. One of the most significant (and often overlooked) costs of doing business today is managing the collection and remittance of sales and use tax.

As a revenue source for states, sales tax is one of the most common, along with property tax and income tax. And states aren't the only jurisdictions hungry for revenue; cities, counties, and other municipalities often require their own pieces of the revenue pie. During recessions and periods of slow growth, revenue shrinks and scrutiny of tax returns increases, placing your business at a higher risk if you don't properly collect and remit sales and use tax.

Most people accept the costs of doing business and try to follow the rules. Complexity is the challenge most companies face in complying with the regulations associated with sales and use tax, because "complex" barely describes the regulations.

One common theme comes through as you read this chapter: The only universal truth associated with sales and use tax compliance is that nothing is uniform; rules, rates, and responsibilities change not only over time, but also between jurisdictions.

Understanding Nexus

Rules exist that define when you, the seller, must collect sales tax from a customer. So, let's start by considering whether you're legally responsible for collecting sales tax.

REMEMBER

There are a variety of reasons why a customer may not pay sales tax, described in the section "Covering Your Bases with Exemption Certificates." If a customer doesn't pay sales tax, he's probably liable to pay use tax, described in the section, ". . . And Then There's Use Tax." Sometimes, sellers are also buyers, so they're affected by both sides of the equation: collecting and remitting sales tax and calculating and remitting use tax.

Nexus is the connection between a business and a state in which the business operates. As a function of this connection, the business acts as an agent for the state's tax authority and collects and remits sales taxes accordingly. You can think of nexus as a seller's obligation to collect and remit sales tax where business is conducted. Generally speaking, every business with nexus in a sales tax state has to calculate, collect, report, and remit sales tax to some extent.

More than likely, you're already collecting, reporting, and paying taxes in your state and local jurisdictions. However, what happens when you sell something across state lines? Are you required to collect sales tax and, if so, how much? And to whom do you remit the tax? And when must you remit it?

Nexus rules are established by individual states, and every state defines them uniquely, making nexus one of the most misunderstood, misinterpreted, and underestimated issues when it comes to complying with sales tax regulations. Succinctly put, nexus isn't static.

Determining exactly how a rule applies to a business is critical. At one time, companies could use a decision by the U.S. Supreme Court in *Quill Corporation* v. *North Dakota* (1992) as a guideline. As a result of that case, states couldn't require companies to collect state sales tax unless those companies had a significant physical presence, like a warehouse or storefront.

And then e-commerce began to emerge as a driving force. Initially, many e-commerce merchants didn't have to charge sales tax because they were selling across state lines but not maintaining a physical presence in other states.

But that standard has since changed. In an effort to increase state revenues, many states redefined or expanded the definition of *physical presence* nexus to include more common business activities such as

- Hiring employees who work from home outside your state
- Attending tradeshows or sending sales representatives into different states
- Using a third party to fulfill or deliver orders to out-of-state customers

Chapter 2 covers in more detail business activities that trigger nexus.

And, on June 21, 2018, the Supreme Court made a landmark ruling in *South Dakota* v. *Wayfair, Inc.*, upholding the state's right to impose sales tax on remote sellers based on *economic nexus* (the volume or dollar value of sales into a state) and not just physical presence.

In addition to South Dakota, 27 states now have economic nexus laws, and more are likely to follow. What that means is that, in addition to states where you have physical presence nexus, you could be required to collect and remit sales tax on sales into states where you meet the minimum thresholds for economic nexus.

REMEMBER

Economic nexus is based on sales into a state that meet a certain revenue or sales volume thresholds, which varies by state. You can find more about economic nexus, including a state map and sales thresholds, at `https://avlr.co/wayfair`.

For the seller, this can make sales tax compliance much more complicated, and the potential for increased nexus errors drives up the risk of audit.

TIP

If you have concerns about whether your business activities are creating nexus, consider having a nexus study done.

There's Sales Tax . . .

Sales tax is a tax a customer pays on items he purchases for his own use at the time he makes the purchase. When a customer makes a purchase, he pays the tax and his responsibility pretty much ends. But if you, the seller, have nexus, your responsibility *begins,* because you collect the tax and then send it to the appropriate taxing authority along with a tax return that explains how you arrived at the amount you're remitting.

Sounds simple enough, but then you start running into potential complications, such as, "Do you need to collect taxes only for products and not for services?"

Enter the jurisdictional issues. Even if you sell in one location primarily, you may need to collect tax for multiple jurisdictions — your state, your county, and your city — and different jurisdictions have different tax rates.

REMEMBER

Gone are the days when you could use zip codes to identify taxing jurisdictions and their associated tax rates. Both zip codes and jurisdictional boundaries change constantly. Studies have shown that 28 percent of reporting errors are due to customers being invoiced using an incorrect sales tax rate.

Things get even more complicated if your business operates in multiple states, because — you guessed it — each state has different rules, tax rates, and remittance requirements.

Sellers are obligated to collect sales tax using the rules of the location where the sale takes place. Sellers use *sourcing rules* to establish the location where the sale takes place and to determine, for interstate transactions, which state dictates the taxability of a particular transaction and the rates and rules that apply to the transaction. ***Remember:*** Nothing is static; everything changes.

TIP

The tax on sales made at a brick-and-mortar store is almost always calculated based on the point of sale.

As a general rule, most states in the U.S. use a *destination model,* which means that you, the seller, charge sales tax using the rules in place at the customer's location. For those states using an *origin model,* you, the seller, charge sales tax using the rules in place at your business's location.

For manufacturers, wholesalers, and distributors, particularly those that operate in multiple states, the supply chain complicates sales tax liability. Read more on this issue in the sections, "Let's Not Forget the Supply Chain" and "Covering Your Bases with Exemption Certificates."

Last, but certainly not least, in the discussion of sales tax, you need to know when and where to remit the tax. In some cases, you remit all the tax you collect to the state, which then divvies up the tax between various other taxing jurisdictions within the state. In other cases, you remit directly to each individual taxing authority.

Does your head hurt yet? Keep reading.

. . . And Then There's Use Tax

Typically, if you make a purchase in your home state, you pay sales tax at the time you make the purchase. But if you purchase something and *don't* pay sales tax, use tax comes into play.

Use tax is tax on the use of tangible personal property not otherwise subject to sales tax. Use tax is imposed by most states in the U.S. on both individuals and businesses. Like sales tax rules, use tax rules vary by state (remember that theme).

Generally speaking, a buyer owes use tax on taxable items purchased on which the buyer paid no sales tax or less tax than the applicable sales tax rate. Unlike sales tax, the remittance responsibility lies with the buyer (either a business or an individual).

You (both individuals and businesses) are liable for use tax if you purchase an item that you use, give away, store, or consume in your home state without paying sales tax to your home state. In some cases, the purchaser may be a business, such as a manufacturer or a distributor, buying goods outside the state or online, to use, give away, or consume as tangible personal property.

For example, you should pay use tax if you

- Buy a taxable item in another state without paying sales tax and bring that item into your home state, where it is also a taxable item.
- Buy an item by phone, by subscription, or from a mail-order catalog company without being charged sales tax.
- Buy something over the Internet without paying sales tax.

Businesses must also pay use tax on goods they withdraw from inventory for their own use or give away as donations or promotions.

THE PERILS OF NOT RECOGNIZING A USE TAX LIABILITY

Here's the situation: Oil refineries purchase crude oil to refine it into saleable products. Refineries typically refine *all* the crude oil; they don't use any of the crude oil in its unrefined state, and no crude oil is left over after the refinery process is complete. However, refineries can't successfully refine all the crude oil into saleable products, and some of those products have no market value.

Three by-products of the refinery process typically aren't resold in any form, but they can be (and usually are) used in the refinery process. Two of them — catalytic coke and process gas — are waste products that have no market value. The third, heavy oil, is a by-product that is sold to heavy industry as a high-sulfur fuel, but heavy oil commands a much lower market price than the "premium products" produced by the refinery, such as gasoline, jet fuel, diesel fuel, and home heating oil.

Although two of these by-products don't have any market value, and the third has a very low market value when compared to the prices of premium products, all three by-products can be (and typically are) used by most refineries in the refining process to generate the heat needed to produce the premium products.

The question here is, "Do you owe use tax on waste products that you reuse?" The courts have determined that, in most states, yes, you do. And if you don't pay use tax on the value of the waste product used by the refinery, you can expect a tax auditor to charge you back taxes as well as penalties. Yep, garbage may be taxable.

Use tax is typically, but not always, assessed at the same rate as sales tax and is based on the rate for the tax jurisdiction where the item was received or consumed.

WARNING

It is an individual's and a business's responsibility to self-assess and pay use tax to the state and/or local tax authority.

Businesses usually need to file a special return often referred to as a *sales and use tax return.* Individuals usually report and pay use taxes with their state income tax returns, but in some cases, individuals must also file use tax returns for larger transactions such as vehicle purchases that are subject to use tax.

Some states allow deductions for sales taxes paid to other states on the items purchased and may also exempt some items or transactions from use tax, such as food and prescription medications. Purchases made by government agencies and nonprofit organizations are generally exempt from use tax but not necessarily from sales tax.

To better enforce use tax compliance, several states have adopted use tax reporting requirements, which require non-collecting retailers to either collect sales tax or provide states with information to facilitate use tax collection. Use tax notice and reporting laws vary by state but generally require non-collecting sellers to

- Inform purchasers at the time of sale that sales or use tax may be owed on the transaction
- Provide an annual purchase summary to purchasers
- Provide an annual customer information report to the department of revenue

The common belief is that states are adopting these rules to encourage non-collecting retailers to register to collect sales tax rather than take on the more arduous task of complying with use tax notification and reporting requirements, which are not only time-consuming (maybe even more so than sales tax), but also potentially damaging to customer relationships.

The nation's first use tax notification and reporting law took effect in Colorado on July 1, 2017. As of December 2018, 12 states and Puerto Rico have some form of use tax reporting requirements for non-collecting sellers.

TIP

If you're on the fence about whether you should start collecting sales tax or comply with use tax reporting requirements, think about this: Would your customers rather pay sales tax or have their personal information (and buying habits) shared with state tax authorities?

Let's Not Forget the Supply Chain

Many people believe that sales and use tax are relevant only for retail sales and then only at the point of sale. Not true. Noncompliance with sales and use tax rules can surface in companies all along the supply chain and in diverse business processes and departments.

Manufacturers, wholesalers, and distributors are participants in the *supply chain*, a term describing the process of efficiently moving raw materials and end products from one point to another until they end up in the consumer's hands. Participants in the supply chain include raw materials vendors, manufacturers, wholesalers, distributors, resellers, retailers, and finally, end consumers. Different kinds of technologies — such as strategic sourcing systems, enterprise resource planning (ERP)/order management systems, and ecommerce — exist within the supply chain to simplify procuring and moving goods.

Tax compliance along the supply chain is, as you may imagine, difficult, particularly those that operate in multiple states:

- As described earlier in this chapter, every state and jurisdiction has its own rules for defining nexus, product taxability rules, and order sourcing rules to determine taxability of the product being sold.
- Jurisdiction boundaries change regularly, along with state and jurisdiction tax rates, various tax exemptions, and a myriad of specific product taxability rules.
- Every company functioning in a supply-chain process understands "tax compliance" in a different way, based on its products.
- Different procurement, order entry, and e-commerce technologies are used within the supply chain.
- Automated tax technologies vary in sophistication.

Participants in the supply chain often use drop shippers, which can change the taxability of a transaction. A *drop shipper* is a third-party shipper that delivers goods directly to the customer from the manufacturer. Typically, a seller accepts an order from a customer, places the order with a third-party manufacturer or wholesaler, and directs the third party to deliver the item to the customer. The third party may deliver the item using its own truck, arrange for delivery by common carrier, or arrange for the customer to pick up the item from a warehouse location.

So, the first question is, "When using a drop shipper how do you determine the sales or use tax obligation?" As you may expect, the answer lies with nexus:

- If the retailer has nexus in the state where the sale occurs, the retailer collects sales tax from the customer, even if the retailer engages a third-party drop shipper to deliver the product who also has nexus in the state where the sale occurs.
- If the retailer doesn't have nexus in the state in which the sale occurs, but the drop shipper does, the drop shipper may need to collect sales tax. Most states don't consider the transaction between the retailer and the drop shipper a taxable transaction, as long as proper documentation — a resale certificate — is provided to the third-party drop shipper. However, several states do hold the third-party drop shipper responsible to collect sales tax when the out-of-state retailer lacks nexus.
- If neither the retailer nor the drop shipper has nexus in the state where the sale occurs, the customer is responsible for paying use tax.

Next, you may want to know if the activity of drop shipping is a nexus-creating activity. In some states, using an in-state drop shipper by an out-of-state retailer can create nexus for the out-of-state retailer, creating an obligation for the seller to collect sales tax on the taxable sale.

To add to the confusion, the taxable amount of the sale varies from state to state. Some states consider the retail value of an item taxable, while other states tax only the wholesale price.

Finally, you need to deal with tax exemptions.

Covering Your Bases with Exemption Certificates

After everything you've read in this chapter, guess what? You don't always need to charge or pay sales or use tax — just another example of how there are no hard and fast rules when it comes to complying with sales tax regulations. But don't get too excited; managing exemption certificates can be as overwhelming as trying to comply with sales tax regulations.

Exemption certificates are typically presented to a seller by a customer. Properly completed, an exemption certificate relieves the seller of the responsibility of collecting sales tax from the customer.

REMEMBER

At the same time that taxing jurisdictions are hungry for revenue, businesses are equally devoted to reducing their tax liabilities to increase their profits. Undercharging or overcharging sales tax can impact customer satisfaction and loyalty.

Generally, certificates are needed for exemptions based on the customer's business or how the customer will use the purchase. But here comes that theme again: The forms for exemption certificates vary by state. Sometimes one form works for all exemptions, and sometimes there are specific certificates for certain sets of exemptions. Plus, in some states, some exemption certificates expire and need to be renewed to continue to be valid, but other exemption certificates never expire. (The theme reappears, in all its glory: Nothing is the same and things keep changing.)

There are several different types of exemptions, and most states have the following exemption categories:

- **Resale:** The resale exemption certificate is valid when the buyer intends to resell the purchase or use it as an ingredient in something he will manufacture.
- **Agriculture:** The agriculture exemption certificate is valid when the buyer intends to use the purchase in farming, cattle, or nursery-type activities; this exemption category sometimes includes forestry and aqua-culture.
- **Direct payment:** The direct payment exemption certificate is valid when the buyer and the state have agreed that the buyer can pay their use taxes directly, relieving the seller of the responsibility of collecting sales tax.

In addition, many but not all states offer the following exemptions; these exemptions are not as universally available as the ones listed previously:

- **Nonprofit organizations:** The nonprofit organization exemption certificate is valid when a charitable organization has registered with the state and provides the certificate to the seller for tax-free purchases.

- **Government:** Government agencies are often exempt from paying tax on purchases; these exemptions are often documented by paperwork such as contracts or purchase orders, but states do use certificates for this exemption.
- **Manufacturers:** Manufacturers can provide exemption certificates for purchased equipment and supplies they intend to use in the manufacturing process.

Less often, you may see exemption certificates in other areas, including commercial fishing, mining, out-of-state custom printing, enterprise zones, and research and development.

REMEMBER

Not all exemptions are available in all states.

The biggest impact of exemption certificates — besides saving the buyer money in taxes and the seller paperwork in remitting them — is the collection and management of the certificates.

When you consider that sales tax in the United States is typically imposed on the customer, you realize that every tax-exempt step along the supply chain involves either a manufacturing exemption or a sale for resale. Each company in the supply chain, except for the retailer, has to both issue and collect an exemption certificate. After all, both the buyer and the seller have to be able to prove to an auditor that a particular sale did not require the collection or payment of taxes.

REMEMBER

Most states don't consider the transaction between the retailer and the drop shipper taxable if the retailer provides a resale certificate to the drop shipper. And many states allow out-of-state certificates. For example, if a drop shipper is in New York and the retailer is in Washington, New York will accept the retailer's Washington State resale exemption certificate number.

So, managing exemption certificates is no simpler than complying with sales tax regulations. It's also safe to say that manually managing tax-exempt sales and associated paperwork not only increases risk of audit, but also ultimately costs more in manpower and other resources than outsourcing does.

THE STREAMLINED SALES AND USE TAX AGREEMENT

The Streamlined Sales and Use Tax Agreement (SST) was created to simplify and modernize complex state sales and use tax requirements, particularly for remote and multi-state sellers. To date, 24 states have adopted the measures in the agreement, which means they've agreed to

- A central, electronic registration system for all member states
- Allow sellers to remit sales tax to a single state agency
- Use the same tax base and taxing rules for state and local jurisdictions, so that the goods and services are taxed or exempted the same way within each state (each state retains the choice of whether an item is taxable and at what rate)
- Apply uniform sourcing rules to all taxable transactions
- Accept one SST-certified exemption certificate for exempt sales

To be eligible for SST, your business needs to work with an SST-certified provider. The good news is that, by becoming SST-qualified, your business can register, file returns, and get additional tax help at no cost (the states picks up the tab). Learn more at `www.avalara.co/SST`.

IN THIS CHAPTER

» Knowing your nexus

» Registering to do business

» E-filing

» Knowing when to file

» Dealing with sales tax liability prepayments

» Automating to succeed

Chapter 2 How Well Do You Comply with Sales Tax Regulatory Requirements?

Before you take action in any arena, you need to know your current position in that arena. Complying with sales tax regulations is no different; you need to assess how well your business currently functions in a variety of ways so that you can find methods to improve compliance. Complying with sales and use tax regulations can, in the long run, save you time and money by helping you avoid an audit.

As you read in Chapter 1, sales tax filing and reporting rules vary between jurisdictions in significant ways. Each state has unique filing schedules, forms, payment thresholds, and other administrative requirements, making keeping up with rules challenging.

This chapter explores issues associated with filing properly so that you can avoid costly penalties and fines.

Do You Know Your Nexus?

Nexus is the connection between a business and a state in which the business operates. As a function of the connection, the business acts as an agent for the state's tax authority and collects and remits sales taxes accordingly. More simply put, nexus is a seller's obligation to collect and remit sales tax where business is conducted.

Knowing where you have nexus keeps you ahead of the auditor and gives you a leg up on the competition.

Nexus rules are established by individual states and, of course, every state defines them uniquely. Whether a company has a sales tax obligation is the crux of the sales tax challenge.

With approximately 12,000 jurisdictions within the U.S. and tens of thousands of rate and rule changes annually, few manual systems can manage these variables to help you correctly determine your liability.

REMEMBER

Determining where a business has nexus is complex, especially for businesses selling in multiple states. The criteria you use to determine nexus change from state to state. In most states, nexus is triggered by a physical presence in a state, such as a warehouse or distribution center.

In many states, nexus is also triggered by a virtual connection, such as a remote relationship with a vendor or online advertiser. For example, large online retailers such as Amazon and Overstock collect sales tax both in states in which they have distribution centers or warehouses and in states where they have no physical presence but do have a virtual presence.

More recently, more than two dozen states have instituted economic nexus, which imposes sales and use tax on sellers with substantial sales into a state based solely on sales revenue or transaction volume. These thresholds vary by state. A chart of states with economic nexus and thresholds can be viewed at `https://avlr.co/wayfair`.

TIP

A nexus study can be a worthwhile investment to ensure compliance.

Registering to Do Business

When you determine where your company has nexus, it becomes your responsibility to collect sales tax on behalf of the states in which you have nexus; as part of that responsibility, you must file and remit sales tax.

Knowing where, when, and how to register to pay tax is crucial, and sales and use tax obligations and filing requirements can confuse even the most knowledgeable tax analyst.

Most states require businesses to register with the state if the organization is formed as a corporation, a nonprofit organization, or a limited liability company. But registration doesn't end there. Most states also require registration if you plan to transact business in the state. That is to say, you may have formed and organized your company in one state, and conduct business in that state, as well as other states. In this case, you must register your organization in multiple places: the state where it's organized as well as, in most cases, the states where your organization will do business.

Sales and use tax registration processes vary from state to state (naturally). As mentioned in Chapter 1, the Streamlined Sales and Use Tax Agreement resulted from an effort to find solutions to simplify the existing complex state sales tax systems. Businesses selling into the 24 states that participate in the Streamlined Sales and Use Tax Agreement can use one form to register for all participating states.

Businesses selling into states that don't participate in the Streamlined Sales and Use Tax Agreement, or in only a few states that participate in the agreement, can find individual registration rules and requirements on individual state sites.

To e-File or Not to e-File . . .

Following the example of the IRS, many states are starting to require electronic filing and payment of sales tax. And, once again, the e-filing requirements change frequently, so, knowing the requirements of the various states in which you do business is, well, challenging.

For example, depending on where your company is registered and where you have nexus, you may be required to electronically file all returns or only some returns. Or, you may be required to file electronically, depending on the amount of the return. In some states, if the amount of the return exceeds a specified amount, you must e-file, and if the amount of the return is below the state's threshold, you don't have to e-file. Every state sets its own rules on this subject; if a state has e-filing rules, the threshold varies from state to state and may not exist at all in some states.

Just to highlight a few of the different sets of rules you may find, all business tax forms must be filed electronically in Indiana. But in New York, e-filing is required only for businesses with broadband Internet.

TIP

Visiting individual state websites is one way to obtain information. You also can turn to experts such as CPAs or tax analysts to find answers. Additionally, you can use tax automation software to keep track of filing dates and deadlines and file returns for you.

Avoiding Late Filings

Late filing is an easy way to incur fines and late fees that, of course, affect your bottom line in ways you don't want. To add insult to injury, paying sales tax obligations late consistently can be a red flag for overeager auditors grasping for more revenue on behalf of struggling states. Filing late is like raising your hand and saying, "Me! Please audit me."

So, you certainly want to file your return in a timely fashion. And that shouldn't be a difficult goal to achieve, right?

Well, filing on time can be easier said than done. Why? Every state has its own schedule for when your business must file its sales tax returns. Many states base your filing date on the amount of sales tax you owe.

TIP

Some states require that you prepay sales tax, which can affect the schedule you must use when you make payments; for more information, see the next section, "Calculating Remittances Accurately." If your company is required to make prepayments and remit sales tax in multiple jurisdictions, you could end up managing multiple filing schedules.

SALES TAX DISCOUNTS

Be aware that some states offer allowances to companies that consistently file accurate and timely returns. And, some states offer a discount to the company filing the return to try to help compensate for the time and effort spent on record-keeping. But most sellers will tell you that the discount amount doesn't begin to cover their costs in managing sales tax collection, remittance, and exemption certificates.

TIP

If you've filed late (or not at all), be aware that some states also periodically offer amnesty for overdue tax liabilities. For a list of states with amnesty programs, visit `www.streamlinedsalestax.org/index.php?page=states-offering-amnesty`.

REMEMBER

Remaining on top of changes to state filing schedules, as well as tax amounts that may trigger prepayments or a different filing schedule can be the difference between late filing penalties and no late filing penalties.

Handling Sales Tax Prepayments

Some states, including but not limited to California, Mississippi, and North Carolina, require that you prepay your sales tax liability; typically, states require prepayment of sales tax if your liability exceeds a threshold established by the state. To make sales tax payments accurately and on time, check the prepayment requirements in applicable jurisdictions.

Often, prepaying sales tax involves a different filing schedule than the one set for sellers filing regular returns. In addition, in some states, prepayments are due more than once a month; you may be required to make payments on a weekly basis. Once again, the rules depend on the state and on the threshold.

In cases where you prepay sales tax, you're effectively estimating the amount of tax you'll owe, typically based on sales you made the previous year in the same time frame. When you fill out your sales tax return, you reconcile the amount you actually owe with the amount you prepaid on your sales tax return.

To determine the amount you actually owe and prepare your sales tax return, you invariably use great volumes of data. And in any situation, great volumes of data can lead to inaccuracies and oversights, particularly when you handle the data and associated calculations manually.

Considering Automation

If there's one concept to take away from this chapter, it's that the rules are different in the various taxing authorities. With so many different rules, you need to wade through a pile of data to accurately calculate your sales tax liability, as well as determine when and how to pay it.

One of the best ways for you to stay on top of filing, registration, and remittance is to utilize automated systems. See Chapter 4 for more information on automation and sales tax compliance.

IN THIS CHAPTER

- Identifying the risk factors that can lead to an audit
- Exploring the costs of not complying with sales and use tax regulations
- Reviewing business processes to reduce the odds of being audited
- Examining the nightmare of managing exemption certificates

Chapter 3 What You Need to Know to Avoid a Bad Audit

Nobody wants to be audited. It's about as much fun as having a root canal. Even the folks who believe they do everything 100 percent correctly do not want to be audited.

So, are there things you can do — actions you can take — to make the process less onerous and avoid a bad audit? Yes. Read on.

The Audit Process Uncovered

Unless you've been through an audit before, you likely have no idea what to expect, never mind why the state is looking at you or why your business has been selected for an audit.

A research report by Peisner Johnson and Avalara looked at extensive sales and use tax audit data from Texas and California and found that certain factors such as industry type, audit history, and a high ratio of exempt sales to total sales, led to a higher risk of being audited.

The three errors most identified by auditors during an audit are:

- Not charging tax on out-of-state sales
- A difference in recorded vs. reported tax collected and remitted
- Not properly documenting exempt sales

While you may not be able to head off a sales tax audit, you can make the process less painful by understanding your tax obligations better and making it easy for the auditor to verify that you are collecting and remitting sales tax correctly.

Understanding the Cost of Noncompliance

One of the most striking misconceptions about sales tax compliance, according to the 2017 Wakefield Research Survey on Sales and Use Tax Compliance, is the belief among accounting professionals that a company is only at risk of being audited by states in which it files and remits sales tax.

In actuality, states now routinely conduct audits on companies regardless of where they're headquartered or where they've declared nexus. That fact alone should make clear that audits are a high-risk area for any business. The survey found that the average audit costs a company more than $301,400 (see Figure 3-1). Did that get your attention?

The same survey found that, on average, accounting professionals spend 39 hours a month on sales and use tax compliance-related tasks; that's approximately 25 percent of their time. When you spend that much time on a task, you should want some reassurance that the end product will be accurate — and worth the value of the time spent producing it.

WARNING

Are you aware that liabilities uncovered during an audit can affect the valuation of your company? Costs associated with negative audit findings can wipe out the profits of small to midsize companies.

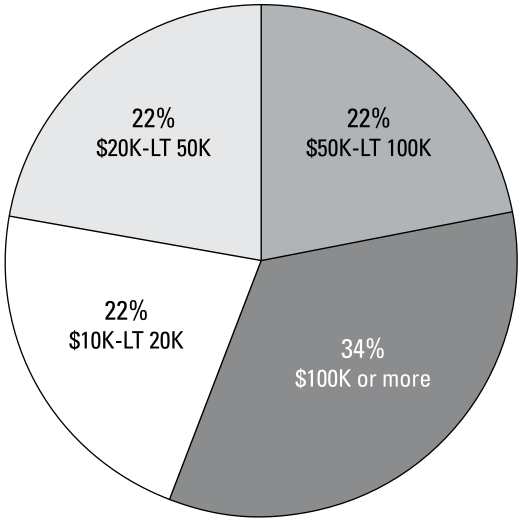

FIGURE 3-1: Approximate cost of audits including penalties and fees, fees paid to outside tax pros, and hours lost producing documents, as reported by companies that had been through the audit process.

Examining Business Process Risk Points

Risk management is usually a high priority with company executives, especially in the areas of finance and accounting where companies face increasingly stringent standards and scrutiny. Until recently, sales tax compliance was not a major focus with company leadership because executives considered noncompliance unlikely and, if it occurred, low in financial risk.

But things have changed. First, over the past few years, new legislation and the increasingly complex rules that determine sales tax liability nexus make compliance very difficult. Second, companies have begun to see that the cost of an audit is *not* inconsequential.

Business-as-usual processes are no longer good enough. You can expect approximately 30,000 changes to rates and jurisdictions per year, but, according to the 2017 Wakefield study, only about half of surveyed companies use an automated solution to determine sales tax rates and taxability rules. Methods used by survey participants appear in Figure 3-2.

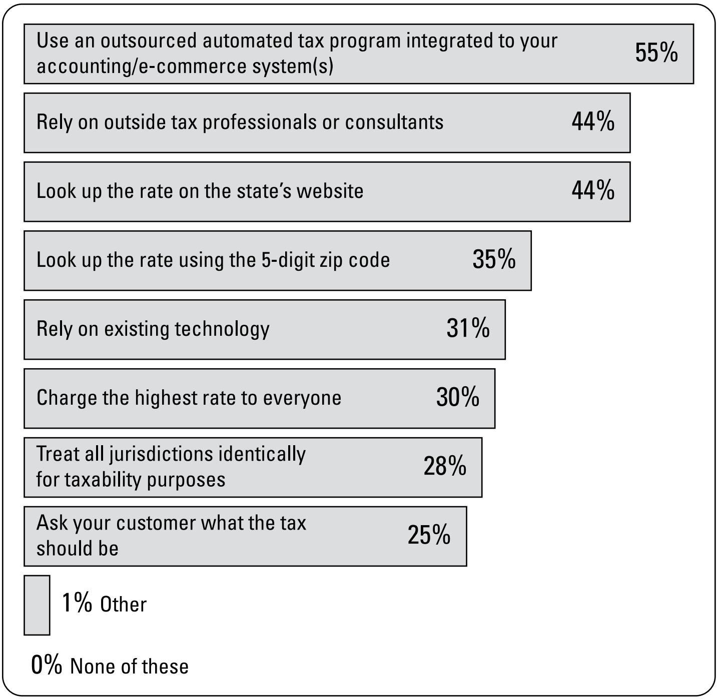

FIGURE 3-2: Methods used to determine liability for collecting sales tax and determining rates.

To help avoid an audit, you should look for any business processes that, if handled improperly, may trigger an audit. Start by ensuring you've accurately determined nexus (your obligation to collect and remit sales taxes in a particular jurisdiction). Accurately identifying your nexus is particularly important if your company sells online in multiple states. Then, if you are obligated, you need to ensure that you use the correct tax rate.

If you've determined that you are liable to collect and remit sales tax, don't fall prey to the common misconception that sales tax is relevant only for retailers, and then, only at the point of sale. Noncompliance can surface in companies all along the supply chain and in various business processes and departments:

» **Purchasing/accounts payable:** Take the time to estimate sales tax on all purchase orders. By estimating sales tax on your purchase orders, you

- Alert your vendors of tax you're expecting to be charged
- Help yourself by properly estimating the total cost of purchase
- Ensure proper purchase order/invoice matching

When a vendor doesn't charge sales tax for a taxable item, you must apply consumer use tax, and taxing authorities expect you to report and remit use tax.

- **Customer relationship management (CRM):** Undercharging or overcharging sales tax can impact customer satisfaction and loyalty. By validating customer addresses, you ensure product delivery and apply the correct jurisdiction sales tax rates and rules to the sale.

TIP

Managing exemption certificates properly and in a timely fashion is also vital to ensuring accurate billing.

- **Inventory:** Make and apply final tax calculations as orders are filled. Remember to supply resale exemption certificates when you purchase inventory items that you will resell. For any items you pull out of inventory to use or donate, make sure you properly record associated use tax.
- **Distribution:** Selling directly to both wholesalers and retailers makes managing exemption and reseller certificates a daunting task for distributors. You need to collect, authenticate, and store valid certificates for every exempt sale or purchase; these certificates need to be accessible should an auditor request to review them.

REMEMBER

Using third-party providers or drop shippers can add complexity to this process with respect to nexus and resale exemption (see Chapter 1).

- **Credit card payments:** Ensure that sales tax is included in the credit card charge preauthorization process when an order is placed. By including sales tax, you prevent the charge from failing if the final bill is greater than the preauthorization amount. If a charge does fail, sellers must manually reauthorize the amount with sales tax to complete the charge.
- **Sales and accounts receivable:** It's easy for errors or oversights to happen because of the 12,000 taxing jurisdictions in the U.S. and more than 9 million rules associated with product taxability. Integrated technological capabilities can save your bacon. For example, use geolocation technology to verify

addresses. And automatically applying real-time tax rates ensures that sales include the correct sales tax rates or exemptions based on both jurisdictional and product taxability rules.

- **E-commerce:** Integrate your company's shopping cart with sales tax management to ensure that the correct rate is calculated for every online transaction. By calculating sales tax immediately in the cart, you reduce cart abandonment and improve customer service; the customer experiences no delays or surprises in the final amount billed.

Risk can happen at any point in the business process cycle and put a strain on your business. These activities have one common feature: They all intersect with the enterprise resource planning (ERP) or the accounting system in some way. And that's good news, because you have a central point from which to work to create compliance. As the saying goes, you are only as strong as your weakest link. Integrating and automating sales tax compliance in your ERP allows you to better manage risk at each point in your business process. (See Chapter 4 for more information on automation.)

Managing Exemption Certificates

Tracking and filing exemption certificates, already a complicated process, has gotten more complicated in recent years. States often change what they exempt from sales tax. More than ever, it's important for business owners to

- Create an audit trail for certificates.
- Update product and service exemption rules in each jurisdiction in which they do business.
- Be able to quickly generate an exemption certificate summary report that identifies inaccurate, incomplete, missing, or expired certificates.

Among the most notable challenges associated with sales and use tax compliance is the tracking of exemption certificates; in many cases, businesses track exemption certificates using inefficient and cumbersome manual procedures. It's not uncommon for businesses to keep paper certificates in a filing cabinet (or two or three or seven). However, these manual tracking environments are cumbersome; documents can get lost, misfiled, or separated from invoices, making it difficult to prove compliance if an audit happens. In addition, because exemption certificates expire at different times for each customer, good practice in a manual environment has somebody going through all the certificates on a regular basis to pull expired certificates and notify customers that they need to supply new certificates — and hopefully that happens *before* a customer with an expired certificate makes his next purchase.

REMEMBER

Twenty-five percent of businesses don't track exemption certificates and don't have any mechanism in place to manage them.

Understanding the exemption certificate life cycle

The *exemption certificate life cycle* is the recurring process associated with exemption certificates. Exemption certificates are created, used in business transactions and sales tax audits, and renewed when they expire or become classified as invalid.

Management of exemption certificates begins with the customer and a sale. When a customer is exempt from paying sales tax, the seller must, by law, collect an exemption certificate from the customer that verifies that the customer is, indeed, exempt from paying sales tax.

But customers often don't know what documentation to provide and those taking the order don't have the expertise in exemption certificates to know which documentation they need. This lack of knowledge — or lack of process — on the seller's part can result in a poor customer experience.

Considering exemption certificate management software

Exemption certificate management (ECM) is, possibly, the most under-automated business function. Why is automating exemption certificate management important? Because automating the function plays two critical roles in your business:

- It helps ensure that you accurately calculate sales tax in situations where exemption plays a role.

» It enables you to fully manage sales tax compliance by integrating ECM software with ERP/billing and tax decision software.

REMEMBER

By connecting ECM, ERP/billing, and tax decision systems, you can manage sales tax compliance effectively. Each system is able to share critical data needed to reduce the risk of audit due to non-taxed transactions, increase productivity by automating manual processes, and improve the exempt customers' purchase experience. You can read more about automating the management of sales tax compliance in Chapter 4.

Automating exemption certificate management is critical for manufacturers, wholesalers, and retailers, as well as for businesses in any industry with tax-exempt sales transactions, no matter the sales channel. The most powerful ECM solutions can handle the collection and management of certificates in direct, retail, e-commerce, point of sale, and tele-sales channels simultaneously and in real-time.

Generally, ECM software comes in two flavors: standard and intelligent.

Standard ECM software

Standard ECM software digitally stores exemption certificates using imaging and indexing, making them easily accessible. In many cases, standard ECM software displays which customers have been sent certificate requests, the date the requests were sent, and whether you've received the customers' certificates. Standard ECM software is often desktop-based software, which requires installation on your staff's computers and routine maintenance to ensure the latest version is installed. Depending on the software, you may need to purchase and install additional releases of the software on each staff member's computer. Because standard ECM software is desktop-based, you can't access it from anywhere other than your desk — no remote office access, no home access, no access when traveling, and no direct access by an auditor.

Standard ECM software provides reports to assist in the management of certificates. The reports usually provide details about customers and their certificates and sometimes highlight staff productivity.

Intelligent ECM software

Intelligent ECM software performs the same functions as standard ECM software, but intelligent ECM software includes additional, powerful features and benefits.

Intelligent ECM software is a web-based solution that minimizes installation cost and time because you need only an Internet connection. Software updates and maintenance are almost never an issue or a cost, because software updates are applied automatically when you log into the software.

In addition to automating the process of collecting exemption certificates, you can import customer records automatically into intelligent ECM software. Intelligent ECM software automatically sends certificate requests to customers and tracks the progress of collecting certificates. You receive notifications when your customers have taken action on a certificate request and sent back a completed certificate. Intelligent ECM software uses rules for each form to track certificate expirations and can send certificate renewal requests before or after certificates expire.

Intelligent ECM software provides the following benefits:

- **Ensures customers fill in all required fields on the correct form.** In cases where certificates sent by customers aren't valid, a review function enables you to mark these certificates as invalid and initiate a request to the customer for correction.
- **Allows certificates to be signed electronically and instantly captured in the system, providing centralized, digital storage of certificates.**
- **Enables you to quickly and easily produce a requested certificate for an auditor.**
- **Supports complex customer relationship hierarchies where a single certificate will apply to many company ship-to locations.**
- **Increases staff productivity.** The software automates and streamlines most of the manual processes commonly associated with collecting and managing certificates. No more Microsoft Excel spreadsheets and mail merges.

» **Looks up, collects, and shares certificate data in real-time for any sales channel — direct, retail, ecommerce, and tele-sales.** The ECM software transfers the certificate data to the tax decision software to make a tax decision — all without disrupting the purchase process.

DOCUMENT MANAGEMENT SOFTWARE IS NOT EXEMPTION CERTIFICATE MANAGEMENT SOFTWARE

Don't fool yourself into thinking that you've got exemption certificate management under control just because you have document management software.

Although document management software centrally stores certificates, it lacks other important ECM features. Because of its static nature, document management software can't help you comply with sales tax regulations and reduce your risk of audit. It also won't increase your staff's productivity or improve the purchase experience of exempt customers — not without disrupting workflow. Intelligent ECM software enhances workflow for manufacturing, e-commerce, retail, wholesale, and many other channels of distribution.

IN THIS CHAPTER

» **Exploring outsourcing sales tax business processes**

» **Automating sales and use tax compliance functions**

Chapter 4
Evaluating Compliance Solutions

To increase savings to the bottom line, prudent and proactive businesses are constantly investigating and implementing new methods to reduce their sales and use tax audit liability and increase staff productivity. And in today's slow economic environment, these goals have taken on added urgency.

Virtually all states are experiencing significant drops in revenue and increased demands for state services. States, like businesses, look for ways to increase savings by either increasing revenues or reducing expenses.

To increase revenues, states are being very aggressive in their sales and use tax audits. In response, astute businesses have already made, or are in the process of making, moves to reduce their sales and use tax liability risks.

The big question is, "What's the best way to manage sales and use tax compliance?" One possible way is to outsource it; another is to automate it.

REMEMBER

Nobody says that you have to take one of these two approaches, but the remaining approaches involve manually processing large amounts of information. And manual processes are time-consuming and error-prone, which makes them unacceptable.

Sales Tax and Business Process Outsourcing

Complying with sales and use tax regulations isn't simple. It's one of the most complicated (and onerous) tasks you can undertake. And yet, as a business owner, you really can't avoid sales tax compliance; you have a legal responsibility to comply. So, what to do?

One approach is to hire someone to do it all for you. Many small businesses rely on professionals such as their CPAs and the QuickBooks ProAdvisors. And these folks can offer good insight into the process and what needs to be done. They can guide you in the right direction. Plus, they typically enjoy doing what they do — and you probably *don't* enjoy managing your sales tax liability.

These folks often do more than taxes, audits, and setting up your accounting software. A CPA is a personal financial planner, a management consultant, a management information specialist, and a business consultant. Most important, CPAs are licensed and regulated by the state in which they operate, and QuickBooks ProAdvisors are tested on their knowledge before being certified. There are even accounting professionals who specialize in state and local tax (SALT).

In addition, other professionals out there make their living doing nothing but guiding businesses when it comes to sales and use tax compliance. These folks provide direction in a variety of areas:

- Sales tax compliance
- Tax registration services
- Help with determining nexus
- Audits
- Specialized tax research
- Voluntary disclosure agreements (to get back on track if an auditor determines that you've had nexus in a state where you should've been filing)

SOME ADDITIONAL RESOURCES

Companies trying to accurately collect, file, and report sales and use taxes face an uphill battle. Here are a few additional resources that may help:

- You'll find a list of websites for each state's Department of Revenue at `www.aicpa.org/Research/ExternalLinks/Pages/TaxesStatesDepartmentsofRevenue.aspx`.
- Avalara offers a variety of white papers and webinars that cover a broad range of topics; including — just to name a few — nexus, sales and use tax, e-commerce and sales tax, and using zip codes and geolocations to determine the correct sales tax rate. You can view these materials at `www.avalara.com/learn`.

For these more complex issues, you may want to look for a *team* of sales and use tax industry experts: former state auditors, database specialists, and tax technicians. This type of team can guide you through various sales and use tax decisions. Assistance from these types of professionals can turn your sales and use tax responsibilities into an efficient, cost-saving management process.

But the help these professionals offer doesn't stop at advising; you can, if you choose, outsource the entire task of sales and use tax compliance. Or you can keep the task in-house and automate it. Read on.

Automating Sales Tax Compliance

Even companies that work hard to accurately track and update changes in sales and use tax rules, boundaries, and rate changes often fail to remit their liability correctly. Knowing which form to use, where to file, and what to include in your returns just isn't simple. At some point, you have to decide what business you're in: the one you registered with your state or the business of researching tax laws.

Even if you hire professionals to help you, that may not be enough. Professionals can guide you, offer good practices to follow, help you determine if you have nexus in a particular jurisdiction, and even research issues of particular interest to you.

But professionals — even the ones who are committed to assisting you in everything from tax research to special projects and exemption certificate managed services — are human, and the amount of data you need to analyze to properly comply with sales and use tax laws is monumental. It isn't easy to continuously review whether your filing schedule has changed, find out whether the states where you have to remit sales tax have implemented new e-filing laws, and know where you need to prepay sales taxes, just to name a few of the responsibilities associated with complying with sales and use tax regulations.

At some point, you may want to consider automating the process.

TIP

Professional assistance and automated solutions are *not* mutually exclusive. If you decide to automate, don't do it alone. Use professionals to help you select a solution and assist in the project of transforming your data for use in the automated system.

In many cases, your company already has an accounting system or possibly even an enterprise resource planning (ERP) system — a suite of integrated applications that your company uses to store and interpret data from a variety of business areas. And your accounting system or your ERP can often handle part of the sales and use tax function.

So, let's assume you're onboard and you want to automate the sales tax management process. Just what does that involve?

Effectively automating the management of sales tax compliance involves connecting ERP/billing software, tax decision software, and the software you use to collect and manage exemption certificates. By connecting the systems, each system can share data needed to accurately calculate sales tax on transactions that require sales tax and simultaneously justify not calculating and charging sales tax on transactions that don't require sales tax.

Essentially, sharing data between the systems increases your odds of making accurate sales tax calculations, which, in turn, reduces your risk of being audited.

REMEMBER

You don't need to throw out the software you already have in place unless it isn't doing the job it's supposed to be doing. In most cases, you can add software to your existing system to fill any gaps you might have currently.

Examining ERP/billing software

ERP software is business management software that companies use to collect, store, manage, and interpret data from many facets of their businesses, including inventory, manufacturing, product planning, service delivery, and marketing. ERP software typically provides information in real-time, and the various departments that provide information to the ERP share information provided by other departments. By sharing information, most organizations find that transaction and production processing errors drop significantly.

Early in their life cycle, ERP systems were used predominantly by large enterprises; however, more and more small to medium-size companies are starting to see the benefits of ERP systems as well.

Businesses that don't use ERP systems typically use billing systems, which focus on the accounting aspect of the business. Billing systems track the company's purchases and sales and produce the documents associated with these transactions, such as checks that pay bills and invoices that reflect customer purchases. In addition, billing systems often track inventory and payroll information and produce financial statements for the company.

Most businesses store information about their customers, such as billing and shipping addresses, contacts, purchase history, and open orders in ERP/billing software. Information about new customers and changes to information for existing customers should be automated and available to other components of the sales tax management system so that you can accurately manage compliance.

In an automated sales tax management system, ERP software sends customer and transaction data to the tax decision software to determine what tax amount, if any, it needs to apply to invoices for customers, and the tax decision software supplies the appropriate rules and rates for the sale. It also sends additions and changes to customer information to the ECM software.

REMEMBER

You don't need to replace your ERP to gain sales tax compliance management functionality. If your ERP works well in other areas, you can add sales tax compliance management functionality to it using third-party software.

Fitting tax decision software into the equation

Tax decision software generally determines the taxability and tax rate of a transaction based upon factors in the transaction such as information about the product being sold, the location of the purchaser and seller, and other factors that affect the taxability of the transaction.

When tax decision software determines the taxability of items on the transaction and the appropriate tax rate, the tax decision software can feed this information into an ERP/billing system so that the invoice reflects the correct amount of sales tax. On the surface, this process sounds fine. But what if tax decision software is operating with incomplete or incorrect information concerning item taxability and tax rates? In most cases, the tax decision software uses information loaded into it to make its decisions; if this information is faulty or incomplete, in all likelihood the tax determination won't be accurate.

TIP

Tax decision software that comes as part of accounting packages often relies on you to keep it up to date with new and changing tax rules and rates. If you do business in multiple states, you may want to consider adding to your existing software a cloud-based, real-time solution that keeps tax rules and rates updated for you.

In addition, exemption certificate data plays a critical role in the tax decision software. If the tax decision software has accurate certificate data, then customers who are exempt from sales tax will be billed correctly. If the tax decision software doesn't have accurate certificate data, not only are exempt customers billed incorrectly, but the seller also increases his audit exposure and risk.

REMEMBER

If you're generally satisfied with your tax decision software, don't replace it. Instead, simply add third-party software to incorporate it into a sales tax compliance management system.

Exemption certificate management software

ECM software automates the collection and management of sales tax exemption certificates. When you include exemption certificate management software in an automated sales tax compliance system, customer data is passed from the ERP software to the ECM software, and, as needed, the ECM software automatically sends requests for certificates to customers. No more file cabinets. In addition, the ECM software passes information to the tax decision software to ensure that correct decisions are made when generating taxable and non-taxable sales transactions.

Generally, ECM software comes in two flavors: standard and intelligent, and you can read more about the difference between the two in Chapter 3.

Intelligent ECM software does a great deal more than standard ECM software. Most important, it can look up and collect, in real-time, certificate information in e-commerce applications and from point-of-sale systems and transfer the certificate data to the tax decision software to make a tax decision — all without disrupting the purchase process. Using intelligent ECM software as part of your automated sales tax compliance system helps ensure that sales tax decisions are made correctly.

TIP

Read Chapter 3 for details on ECM software. The folks at Avalara can outline for you all the benefits of intelligent ECM software over standard ECM software.

If you already have exemption certificate management software, you can integrate it into a sales tax compliance management system using third-party software. If you haven't yet automated exemption certificate management, you can do so and simultaneously incorporate it into a sales tax compliance management system.

Integrating ERP/billing software, tax decision software, and ECM software

To effectively comply with sales and use tax regulations, you need to marry together the functions of

- Your tax decision software, which calculates the amount of tax due for transactions
- Your ERP/billing software, which maintains your customer records and applies the tax calculated by the tax decision software
- The software you use to manage customer exemption certificates

As shown in Figure 4-1, automated sales tax compliance software closely integrates ERP software, tax decision software, and ECM software.

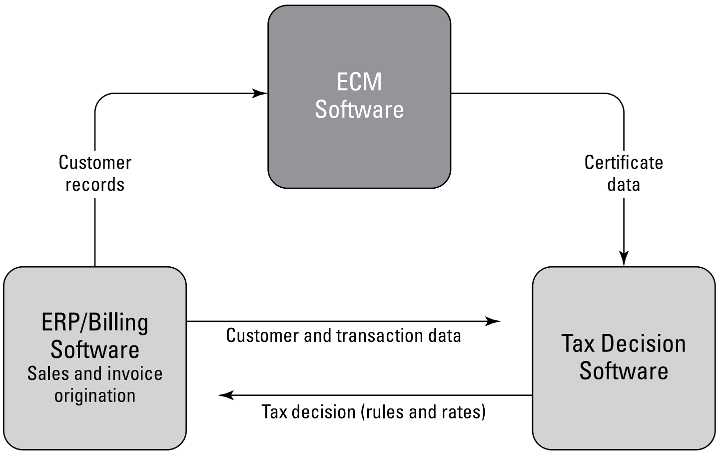

FIGURE 4-1: An automated sales tax compliance management system consists of three software components.

If you don't already have software to automate some portion of the sales tax compliance management system, you can add that software to existing systems. And you can use third-party software to connect systems you already use. There's no need to scrap any existing systems and start over.

In an automated sales tax compliance management system, tax rates are automatically updated as needed, ensuring that accurate rates are applied to the correct transactions so that you collect the correct amount of sales tax. Further, all the jurisdictional data, rules, and changes are current and up to date. And finally, an automated system keeps exemption certificates up-to-date. The shared information ensures that sales transactions are taxed accurately.

You can set up an automated sales tax compliance management system to export updated information from one portion of the system to the others. For example, certificate data can be sent into tax decision software at regular intervals or on demand as transactions are processed.

This process of sharing information trilaterally ensures that sales tax rates, jurisdictional information, and customer data are always accurate. When you make a sale, you'll know that customers have valid certificates and sales tax is billed only when required.

Automating the sales tax compliance management function does the following:

- Connects the three systems to improve visibility of the billing process, reduce data entry errors, and eliminate the necessity to enter data multiple times in multiple systems.
- Enables ERP/billing software to share customer information updates with tax decision software and ECM software.
- Decreases billing errors, because tax decision software rates are automatically updated and tax decision software knows automatically which customers and items are taxable and which are exempt from sales tax.
- Automates sending exemption certificate requests to new customers and renewal requests for expired or invalid certificates to existing customers.
- Increases productivity and efficiency by eliminating paper, manual processes, sales tax refunds, sales tax liability underpayment, and the need for certificate expertise in your credit and sales staff.

Implementing a sales tax compliance management system reduces your odds of undergoing an audit by ensuring that transactions are taxed at the correct rate using up-to-date jurisdictional rates and rules. Exempt transactions are processed only if you have valid certificates on file that you can show to an auditor.

REMEMBER

Technology solutions, along with project assistance to implement them, can help you ensure that your sales tax returns are accurate. And accurate sales tax returns will help you reduce the risk of an audit. As a by-product, you should be able to run your business more efficiently and provide your customers with a more positive buying experience.

Chapter 5

Ten (Or So) Tips for Complying with Sales Tax Regulations

The following sales tax tips may not bring you faster cars, better jobs, or longer trips to Europe, but they will set you on the right side of tax rules and regulations:

- **Review the nexus laws in each state where you conduct business.** Nexus rules are changing and vary from state to state. If you've established nexus, check the state's sales tax laws so that you can accurately calculate, file, and remit sales tax in that state.
- **E-file in the states that require it.** For more information about a particular state's e-filing, prepayment, or filing frequency requirements, visit `www.taxrates.com/state-rates`.
- **Find out whether you're required to make prepayments in any jurisdiction.** Be aware that prepayments can involve different filing schedules than the ones for regular returns.

- **Update filing frequencies on your tax calendars.** Not receiving a filing frequency change notice doesn't mean the new filing frequency doesn't apply.
- **Reconcile your sales tax payable account with your source documents.** Identify the account balance at the beginning of the accounting period. Then add the amount billed to customers and subtract the sales and use tax paid. Compare this amount with the current balance of your sales tax payable account and reclassify any discount or rounding balances in your general ledger.
- **Identify the unique laws in each jurisdiction where you have nexus and plan to sell a new product.** Product taxability laws change from state to state.
- **Ensure that customers' tax-exempt status is up to date and agrees with the term of their exemption certificate on file.** Replace expired exemption certificates to continue not charging tax to your customers. Company name changes may require a new exemption certificate.
- **Even if a taxing jurisdiction makes a processing mistake, you need to take action if you receive a notice.** Failing to respond to notices in a timely manner can result in a levy to your bank account, a lien on your corporate officers, or suspension of your business license. Don't take notices lightly!
- **Verify the jurisdictions where you may have nexus using geolocation pinpoints — latitude and longitude coordinates — to determine exact locations.** Don't use zip codes. Zip codes are a web of streets and postal routes that can be divided and changed as areas become more densely populated. Often, a single zip code includes multiple sales tax rates. If you base your sales tax charges on zip codes, you risk applying the wrong rates and remitting sales tax to the wrong jurisdictions.
- **Ensure that your process for keeping sales records will help you, not hurt you, in the event of an audit.** Look for clear and complete information in your process for keeping sales records. An auditor may want to review accounting

ledgers, along with federal income tax returns, purchase orders, paid bills, invoices, contracts, and customer exemption certificates. An auditor must be able to follow the trail of each transaction and match up all the documents pertaining to each transaction. Watch for items like charge-backs or returns that you may not have documented adequately.

- **Consider automating tax compliance.** Sales tax collection and remittance is not a profit center — it doesn't make money for your business. Instead, it's a cost center. Therefore, focus on minimizing costs. More and more businesses use automated sales tax functions to help minimize costs while complying with regulations.

Make sense of complex sales and use tax regulations

This book helps you understand the constantly changing world of sales and use tax regulation and your responsibilities — your nexus — for collecting and remitting tax. You'll examine the cost of audits and penalties and learn ways to minimize your risk. In particular, you'll discover how automating sales tax compliance can save your bacon. Finally, you'll find out how to properly maintain exemption certificates to justify the amount of tax you charge.

Inside...

- Know which taxes you're responsible for
- Find out where you need to collect tax
- Manage exemption certificates with ease
- Determine whether you need to e-file taxes
- Calculate remittances accurately
- Minimize the risk of an audit and penalties
- Automate the management of sales tax compliance

Avalara

Elaine Marmel has an MBA from Cornell University and has worked on projects to build financial management systems for New York City and Washington, D.C., and to automate accounting systems for small businesses.

ISBN: 978-1-119-58063-8
Not For Resale

9 781119 580638

for dummies® A Wiley Brand

Also available as an e-book

www.blytheco.com/resource-center

949.583.9500
solutions@blytheco.com
www.blytheco.com