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SALES TAX MASTER CLASS:
**Lessons from
a Former State
Auditor**



Disclaimer

While we hope you'll find this discussion helpful, this session is for informational purposes only and is not legal or tax advice.



Meet your presenter



Mary Cho

Tax Director

Avalara

- > Joined Avalara in 2019
- > Works with EMEA and US customers on risk assessments, historical tax exposure and voluntary disclosure agreements
- > Based in Seattle, WA

Agenda

- 1 > Got Nexus?
- 2 > Audit triggers
- 3 > Audit best practices
- 4 > Managing sales tax compliance
- 5 > Consequences of non-compliance
- 6 > Q&A

Got Nexus?

IT ALL COMES DOWN TO NEXUS

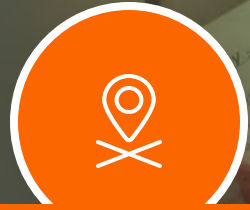
When must businesses collect sales tax?

Sales tax nexus defines the level of connection between a taxing jurisdiction (e.g., a state), and an entity (e.g., seller).

- › Until this connection is established, the taxing jurisdiction cannot require the seller to register and file tax returns.



Type of nexus explained



PHYSICAL NEXUS

Seller has **physical presence** in the state, e.g., office, warehouse, inventory, remote employees and independent contractors or agents.



ECONOMIC NEXUS

Seller exceeds a set level of sales and/or transactions activity within a state at a given point in time.



CLICK-THRU NEXUS

Seller rewards in-state partners or influencers for direct or indirect referrals or leads through website links.



AFFILIATE NEXUS

A connection between a remote seller and in-state seller that may be related in some way or performs certain work that can be attributed to the remote seller



MARKETPLACE NEXUS

Marketplace facilitators may be required to collect and remit sales tax instead of the individual seller if it triggered nexus in a state and provides ecommerce infrastructure, customer service, payment processing services, and marketing.

A GROWING LIST

Physical Nexus-creating activities:



Payroll



Multi-state locations



Warehouse



On-site field service/repair/supervision



Installation / training



Own/lease/rent real or personal property



Field sales/ service staff



Maintain inventory



Affiliates, franchises, partners & influencers



Traveling sales representatives



Commissioned agents or contractors (1099s)



Investors/board members/ employees



Marketing/web advertising



Tradeshows



Delivery in company-owned vehicle

MORE ON ECONOMIC NEXUS

South Dakota v. Wayfair changed sales tax for remote sellers

On June 21, 2018, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair*.

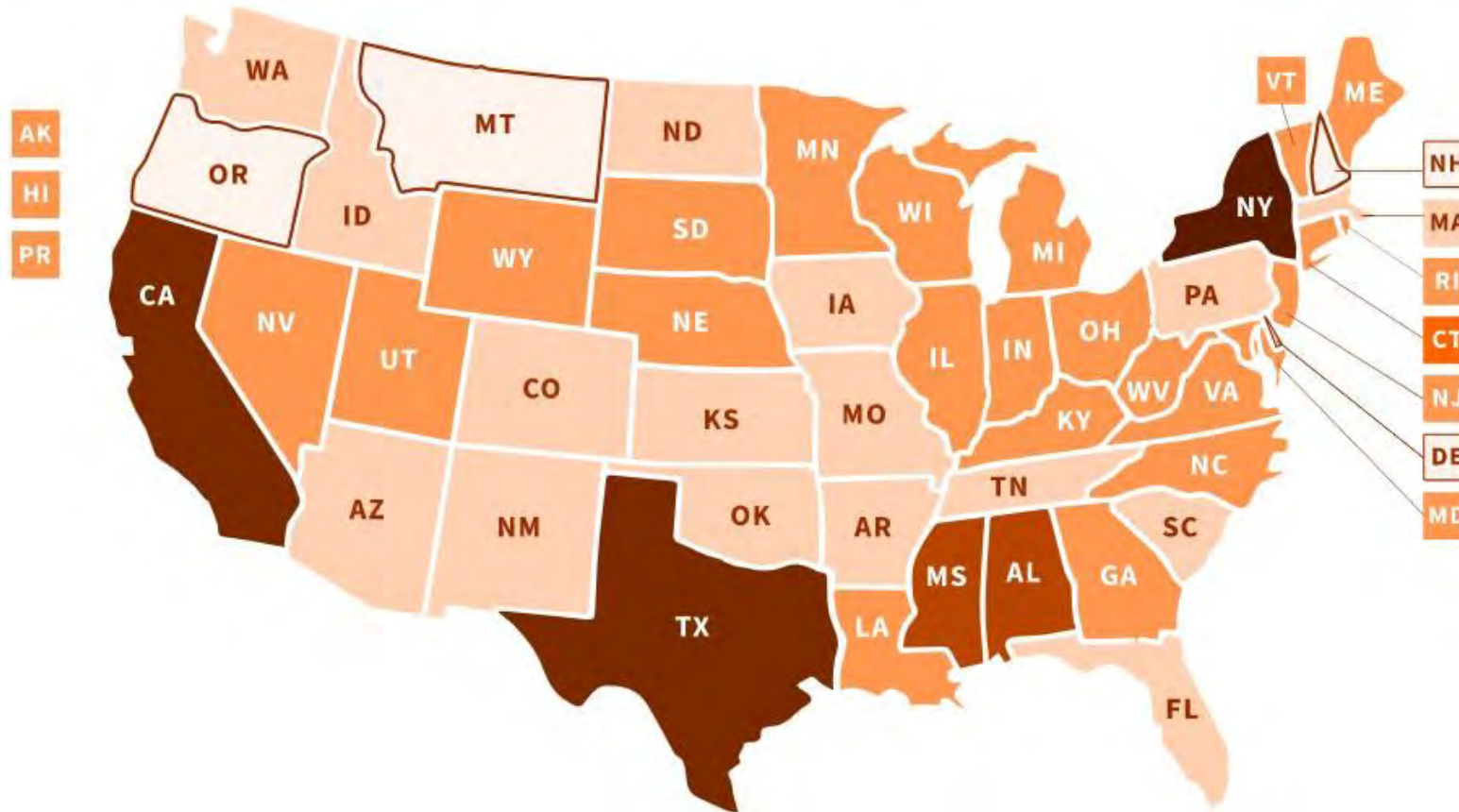
- › The Court ruled in favor of South Dakota. Acknowledged that physical presence was unsound and incorrect in the current age of internet services.
- › Overruled prior physical presence standard as being the **only** nexus trigger.
- › New economic nexus laws allow states to impose sales tax obligations on **out-of-state** sellers based on their level of economic activity in a state.








All 46 states

with a sales tax have adopted economic nexus.

Enforcement date and thresholds vary state-by-state.

Economic nexus thresholds by state



-  \$500,000 and 100 transactions
-  \$500,000
-  \$250,000
-  \$100,000 and 200 transactions
-  \$100,000 or 200 transactions
-  \$100,000
-  Does not have sales tax or economic nexus law

- > Connecticut's threshold is gross receipts of \$100,000 **and** 200 retail transactions
- > New York's threshold is \$500,000 **and** 100 transactions
- > Missouri enforcement date is January 1, 2023.

Updated as of 9/30/22

Question #1

FACTS

- Company A sells furniture
- CA employee since 2014
- 2021 CA gross revenue is \$275,000
- Economic nexus threshold is \$500,000 gross sales of tangible personal property

QUESTION

Did Company A trigger CA nexus?



Question #1



Yes,

Company A has CA physical nexus in 2014 due to employees in the state regardless of the economic nexus threshold.



Question #2



FACTS

- > Company B license software
- > Software is **not** taxable in CA
- > CA employee since 2014
- > 2021 CA gross revenue is \$400,000
- > Economic nexus threshold is \$500,000 gross sales of tangible personal property



QUESTION

Did Company B trigger CA nexus?



Question #2



Yes,

Company B has CA physical nexus in 2014 due to employees in the state regardless of the economic nexus threshold.

Company B will be filing a CA zero tax due return because software is not taxable in the state.



Question #3



FACTS

- Company C sells toys
- No CA employee
- 2021 CA gross revenue is \$650,000 (\$400,000 taxable + \$250,000 exempt)
- Economic nexus threshold is \$500,000 gross sales of tangible personal property



QUESTION

Did Company C trigger CA nexus?



Question #3



Yes,

Company C has CA economic nexus in 2021 due to **gross** sales exceeding \$500,000.

Taxable sales **after** the economic nexus threshold is breached in 2021 is subject to sales tax.



Audit triggers



WHY DO BUSINESSES GET AUDITED?

Common audit triggers

- > Nexus discovery (having nexus and not being registered)
- > Payroll tax or other state and local tax filings (information sharing)
- > Trickle-down referrals through audits of vendors
- > Public information



Internet



Tradeshows



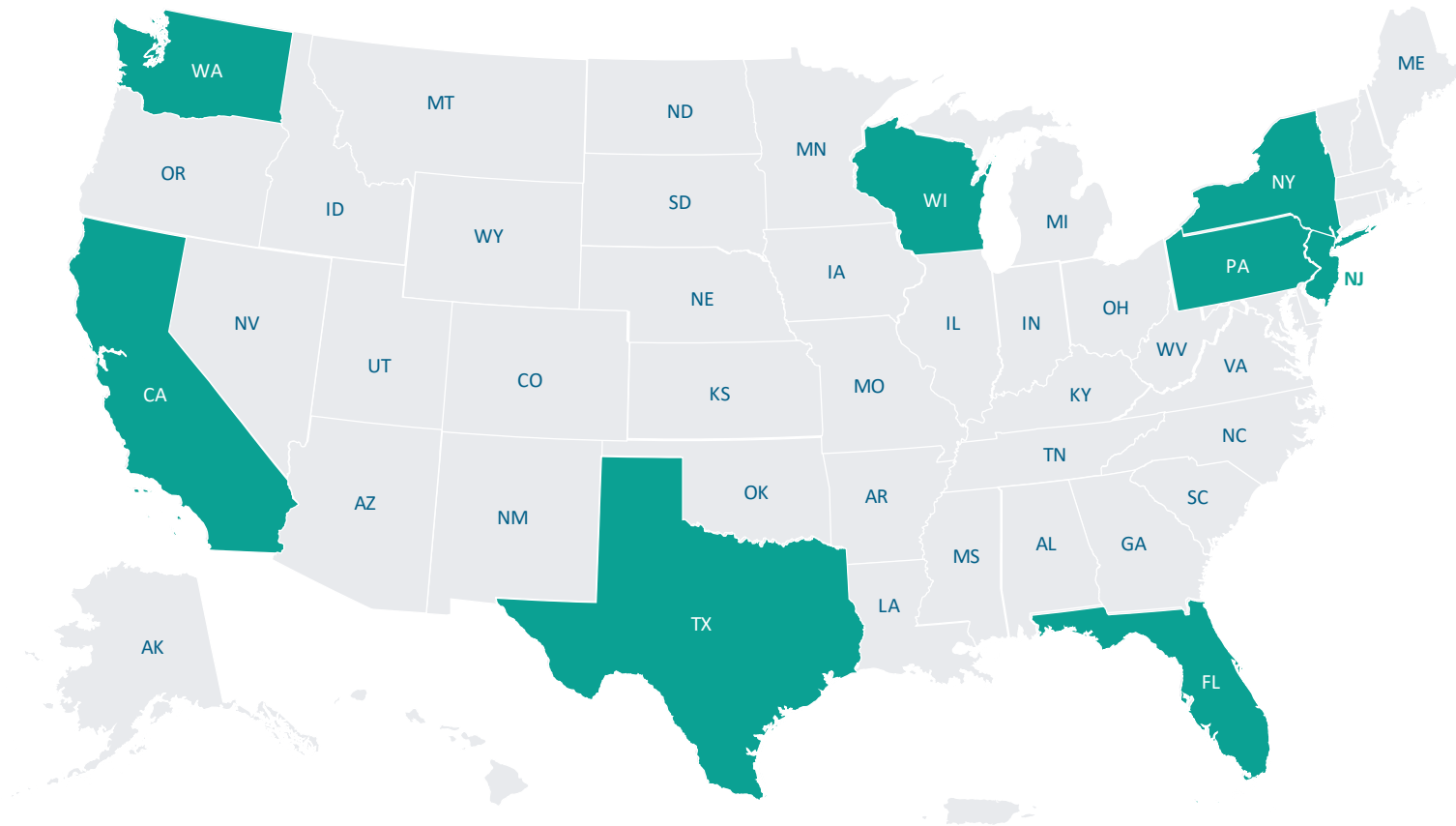
Seller website



Marketplace

- > Leads/list based on certain industries
- > Fulfillment by Amazon (FBA) seller central

Aggressive States in pursuing unregistered taxpayers and audits



- > California*
- > Florida
- > Illinois
- > New Jersey
- > New York *
- > Pennsylvania
- > Texas*
- > Washington*
- > Wisconsin*

Audit best practices

Tips and tricks



Tax is not paid on an honor system

- > Notification: Do not ignore, respond timely
- > Statute of limitations does not apply if never registered
- > Books and records (lack of)
- > Schedule kick off call / understand your business
- > Be respectful
- > Manage the audit and auditor
- > On a need-to-know basis



Contacted for audit?

- > Get everything in writing and over communicate
- > Track deadlines
- > Complete the audit as soon as possible
- > Audit findings and draft schedules
- > Appeal
- > Nothing is final
- > Go at it alone or hire a tax expert

COMMON SALES TAX AREAS
OF NON-COMPLIANCE #1

Unaware of nexus or tax
laws

Taxability of products and services

Tax law changes

Sellers liable for the **uncollected tax, interest and penalties**

Sellers are liable for **not collecting the right amount of tax**

COMMON SALES TAX AREAS OF NON-COMPLIANCE #2

Exemption certificates

CONSIDER THIS

If a vendor closes its doors, it may be difficult to obtain exemption certificates afterward.

Unsupported exempt sales

- > Lack of valid documentation for sales claimed as exempt
- > Date issued does not match invoice date
- > Expired

Missing items on exemption certificate

- > Signatures
- > Issue dates

Incorrect information

- > Wrong claim type
- > Certificate not accepted
- > Document not recognized by state authority
- > Name/address doesn't match direct buyer/seller
- > Wrong state tax ID



COMMON SALES TAX AREAS OF NON-COMPLIANCE #3

Consumer use tax

Buyers will owe consumer use tax when seller doesn't collect tax on purchases including

- › Tangible personal property
- › Freight
- › Some virtual goods (e.g., software or digital content)
- › Certain taxable services

Regulations vary state-by-state

Auditors will expect to see **invoices for all fixed assets** (e.g., computers, equipment, etc.) and **consumable supplies**

Industries at higher risk of use tax noncompliance

- › Manufacturing
- › Retail stores
- › Construction
- › Hospitality

Managing sales tax compliance

The 5 steps to managing sales tax compliance



WHERE

Know where your business must collect and remit sales tax



REGISTER

Register to collect and remit sales tax



CALCULATE

Calculate the correct sales tax amount



TRACK

Track and manage exempt sales



REMIT

Remit sales tax to the tax authority

Avalara
Nexus Study

Avalara
Licensing

Avalara
AvaTax

Avalara
CertCapture

Avalara
Returns

Sales tax risk assessment / Nexus study



Gather information
and data



Identify if and when nexus
(physical and economic)
was triggered



Quantify tax exposure, penalties
and interest based on worse and
best case scenario



Voluntary Disclosure Agreement
(VDA)



State registration



Monitor states where nexus was
not currently triggered going
forward

Consequences of non-compliance

Consequences of non-compliance



Statute of limitations does not apply



Sale tax, interest and penalties will continue to accrue



Inviting sale tax audits



Financial audit accrual for contingencies (ASC 450)



Responsible person rules



Accountability to owners, Board, investors or shareholders



Due diligence triggered by an acquisition

Questions

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Tax compliance done right