The Five Most Important Things Your Clients Need to Know About Sales Tax

By Ray Bigley and Jennifer Warawa

Sales taxes are an increasingly important source of revenue for states seeking to make up for revenue shortfalls. Yet, because sales tax is a pass-through tax, accounting professionals and business owners may disregard it compared to the state and federal income tax landscape.

The risks associated with the failure to comply with sales tax laws should not be underestimated. Sales taxes typically represent more than one third of a state's revenue; in many states, the percentage is much higher. More than likely, your clients are filing returns and paying their fair share, but are you completely certain they are complying in the most efficient manner possible?

As an accounting professional, it makes sense to fully educate yourself on sales tax, learn about the areas where your clients might have exposure and help them understand the implications for their business. Chances are, your clients stand to benefit, but may be unaware that they even have a need.

There are five key points your clients should know about sales tax. Armed with this information, they will be in a better position to reduce the risk of penalty and audit, and improve their accounting practices.

#1: Boundaries and Rules Exist

An understanding of sales tax compliance would not be complete without looking at several factors.

Nexus: In the arena of sales tax collection, one important principle always takes center stage: nexus. In the legal sense, nexus describes the connection between two or more participants, interests or concepts. In the world of sales tax, nexus refers to the connection a company has with a state. Nexus is the legal connection that empowers a state to demand collection and remittance of a business sales tax. If your clients have business in more than one state, nexus laws affect them.

Origin versus Destination: If a sale is taxable, the company must determine which jurisdiction is imposing the tax so it can apply the correct rate, which means the company must first understand the distinction between origin- and destination-based sourcing rules. In origin-based states, any transactions originating *and* terminating within the state are sourced to the origin jurisdiction, so the sale is subject to the local tax rate imposed by the jurisdiction where the sale originated (retail location or ship-from location). Transactions crossing state boundaries are usually sourced to the "destination" regardless of the state's sourcing rule.

Streamlined Sales Tax: In an effort to simplify sales and use tax collection and administration by retailers and states, 44 states, the District of Columbia, local governments and the business community signed on in 2000 to support the Streamlined Sales and Use Tax Agreement (SSUTA). The agreement minimizes costs and administrative burdens on retailers that collect sales tax, particularly those operating in multiple states.

The SSUTA encourages "remote sellers" selling over the Internet and by mail order to collect tax on sales to customers living in the streamlined states, and levels the playing field so that local "brick-and-mortar" stores and remote sellers operate under the same rules. This agreement ensures that all retailers can conduct their business in a fair, competitive environment.

To date, 24 of the 44 states have passed legislation to conform to the SSUTA, yet most of the large states – California, Illinois, New York, Pennsylvania and Texas – have not adopted the agreement.

Recently, states have developed and tested legal theories to push the boundaries of nexus. Some have met with success and some have not; most disconcerting, however, is that some theories are still being vetted in state and federal courthouses.

Attributional Affiliate Nexus (Amazon Laws): If you have clients selling over the Internet, you'll want to know about the "Amazon Law," an affiliate concept currently being pushed by several states. The "Amazon Law" opens the door for states to require sales tax collection in situations where a company has only limited commercial activities within a state. Amazon.com, for example, is already collecting sales taxes in some states. As Internet marketing becomes more complex and entangled, there are more opportunities for otherwise remote activities to trigger sales tax nexus in a given state.

(Editor's Note: Please see the cover article "State Actions and Judiciary Decisions on E-business Taxation" in this issue of *Today's CPA* magazine for more information on the "Amazon Law.")

#2: Reporting Can Be Complex

Understanding the complex calculation and returns and remittance data that can exist for reporting sales and use tax will go a long way in a company's preparation of its sales tax reports and payments.

Calculation: Rules for taxability and calculation vary from state to state, and in some states, by locality. Keeping up with different sales versus seller's use tax rates for the exact same jurisdiction – and determining applications to a specific sale – can be complicated. Automated solutions that maintain all the rates and rules are a necessity for businesses that operate in multiple states.

Returns and Remittance: Once a business decides who it owes taxes to, it must file state and local returns with various taxing authorities. A listing of basic sales and use tax state and local returns for a business can exceed 450 forms. For a multilocation company in multiple states, it's not uncommon to file more than 100 sales/use tax returns per month, while nationwide retailers can easily file over 1,000 sales/use tax returns every single month! As a result, companies doing business in multiple states with limited resources have no choice but to find an automated returns solution.

#3: Technology to the Rescue

Automation is one option a company has for actually preparing its sales tax reports and payments, but others exist as well.

Manual: In a "manual" calculation environment, clients load state, county, city and local tax rates into their accounting software, manually updating the tax tables for rate changes *every time they occur* in each jurisdiction in which the company files.

Hybrid: Clients subscribe to a rate table update service that populates the tax rates in their accounting software for all jurisdictions in which they file. Individual item taxability and customer exemption status are manually updated.

Manual and hybrid solutions are cumbersome and mistakes easily occur if work is not checked and double-checked. In addition, these solutions generally cannot determine when to apply seller's use tax instead of sales tax, and do not allow for accurate calculation of tiered tax rates.

Fully Automated: Locally loaded solutions and hosted, cloud-based solutions allow for more accurate calculation, offering automated tax return preparation or returns prepared and filed through a service provider. Locally loaded solutions are typically two-tiered: 1) the application that actually calculates the sales tax when sales are made, and 2) data used from the first tier to automatically prepare sales tax returns. Automated solutions should be SSUTA-certified to ensure complete compliance.

#4: Cloud Solutions Provide Total Automation, Effortlessly

Hosted solutions for sales tax preparation leverage significant advantages of the cloud. These solutions are ideally suited to handle the constant rate and jurisdiction changes that are the norm in sales tax compliance. Many solutions also offer turn-key sales tax compliance. Here, taxes are not only calculated by the hosted provider, but the returns and payments can all be made by the same provider without the need to transfer data from one system to the other. All changes are tracked and applied by a central service accessed through the cloud. There is no need to load software, perform monthly updates or provide hardware to run a cloud solution; all of this is done by the service provider.

As with locally loaded solutions for sales tax calculations, hosted solutions require setting a company's nexus, product taxability, and customer- or use-based exemptions within the system, and ensuring that they are properly connected to the business's accounting software at the appropriate points. When done properly, the client receives effortless consistency and accuracy with every sales tax calculation.

#5: Communication and Information Are Key

Open communication and information are vital and affect all parties involved in any sales tax relationship. CPAs and their staffs should be aware of sales and use tax collection obligations, but in some cases, there may never have been a conversation on that topic between the advisor and the client. Why?

In general, many CPAs are *not* focused on sales tax because they might think their clients are handling sales tax reporting and compliance on their own. Conversely, from a client's perspective, there may be a presumption that because their CPA is a tax professional, reporting and compliance will be done as simply another component of a typical tax engagement.

As a CPA who is educated in sales tax laws, compliance and reporting, you will be able to transfer your knowledge to your clients. By establishing and maintaining an open dialogue with your clients, you help arm them with the ability to address compliance, reporting and technology issues that may arise – *and* keep them out of tax trouble. ■

Resources for More Information

State Departments of Revenue:
www.govspot.com/tax/staterevenue.htm.

AvaTax Rates:
www.avataxrates.com.

Avalara Accountants Resource Center:
http://auth.avalara.com/portals/accountants-resource-center-aw.

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