Sage ERP | White Paper

Sales Tax Complexities Simplified

States, Rates, and Debates

Introduction

One of the hallmarks of the United States is its decentralized system of government, with states, counties, cities, towns, and even smaller areas all free to decide, individually, how to raise the money needed to pay for the services they choose to provide. While that regional flexibility has worked well for many years, it has evolved into a nightmare for retailers to manage.

States and thousands of taxing jurisdictions within them are able to devise and levy their own sales taxes, set their own rates, and decide what will be taxed—or not. And they do.

As a result, more than 15,000 taxing jurisdictions across the nation have generated a mystifying and complex web of sales and use taxes that are in a constant state of flux as state and local lawmakers decide which goods and services will be subject to their taxes, which will not, and when.

In one month alone, taxing authorities in 26 states made 257 changes to their sales tax rates and rules. Indiana led the pack with 26 changes, and states with sales tax holidays included West Virginia and North and South Carolina. Most changes included new rules expanding taxability on goods and services. But those changes were for just one month. From January through October 2010, state and local Departments of Revenue (DOR) had implemented more than 5,000 sales tax rate and rule changes across the nation.

As states struggle in a recessionary economy with budget cuts and deficits, legislators are using sales tax rate and rule changes to generate revenue in an effort to avoid the unpopular strategy of imposing new taxes. But these tactics only serve to further complicate sales tax compliance for businesses trying to keep abreast of constant changes.

Adding complexity to the situation, a growing controversy exists between Internet retailers and brick-and-mortar stores. Retailers selling over the Internet are generally able to avoid collecting and remitting sales tax, while brick-and-mortar retailers must collect the taxes that support state and local services.

Working to equalize the sales tax situation between Internet and brick-and-mortar businesses, local, state, and federal legislators have created the Streamlined Sales Tax Agreement. In addition to including provisions for Internet taxation, the agreement also is designed to minimize the costs and administrative burdens for retailers selling throughout multiple states.

Making Sense out of State Tax Requirements

Taking note of some of the more obscure state taxes in the U.S., it is almost impossible to understand the logic behind them. In the U.S. there are some highly creative—and sometimes arguably bizarre—sales tax regulations and exemptions:

- Alabama charges a 10-cent tax on any pack of cards that contains 54 or fewer cards in the deck. The seller must also pay $1 and an annual tax of $3.
- Illinois levies a 5% sales tax on candy, where there are very specific definitions to understand. For example, Whoppers, the chocolate malted milk balls from Hershey, are not taxed, but lemon drops are taxed.
- In Minnesota, there is a fur tax. If an item of clothing is comprised of three times more fur than the next most valuable material used to make it, businesses must pay a 6.5% tax on whatever they receive for the sale, shipping, and other charges.
- In New York, any bagel that has been sliced or prepared with toppings is subject to a sales tax. But if it is sold whole and consumed outside of the store, it is untaxed.
- Pennsylvania taxes air—at least the air that comes out of a compressed air vending machine or vacuuming vending machine. So gas stations must charge a tax when customers pump up their tires.

Sage Sales Tax by Avalara: Making Sales Tax Less Taxing

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This is only a small sampling of some of the more unusual and mystifying state sales tax laws. There are many more—as well as thousands imposed by local jurisdictions.

Further complicating the matter, dozens of states also declare sales tax holidays. Some states offer tax reprieves for products like school clothing for kids, while others give consumers a tax break on hurricane preparedness items, like plywood and nails. In states where hunting is a big business, tax holidays might be in place for firearms, ammunition, and hunting supplies. The holidays are varied and complicated, often taking place over specified dates and limiting the number of items that can be purchased tax-free.

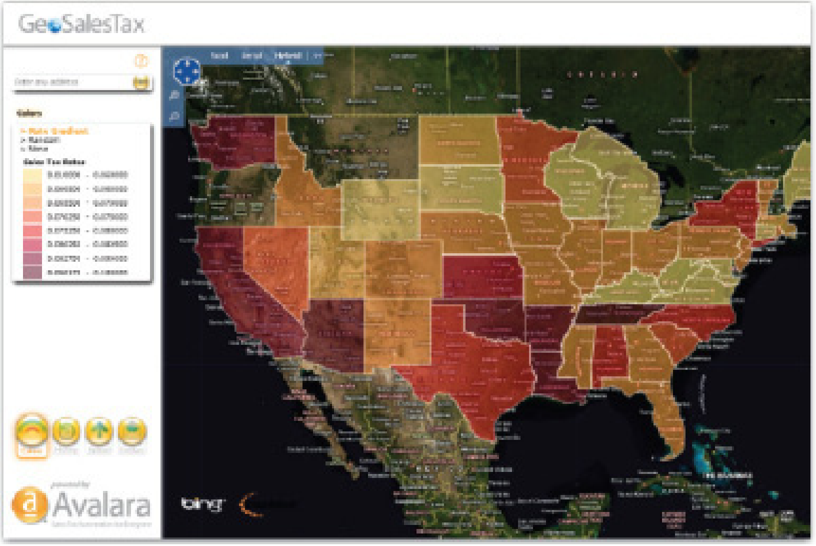
The Tax Rate Roller Coaster

Sales tax rates and collection practices vary widely in the thousands of taxing jurisdictions across the nation, with special taxing jurisdictions such as transportation or stadium districts, police jurisdictions, environmentally sensitive areas, and even individual retail locations such as specific malls or shopping centers. In Arizona, for example, businesses may fill out an Arizona tax return but also must file a separate city tax return where the business is located. Nationwide, businesses must cope with a huge variety of differing rates and boundaries.

In Colorado, the situation is particularly complex. The state imposes a 2.9 percent sales tax on tangible personal property, including cigarettes. In addition, recent legislative changes have eliminated the state sales and use tax exemption for certain items in an effort to help balance Colorado's budget. Effective this year, candy and soft drinks, including those sold in vending machines, are no longer exempt from Colorado sales/use tax.

Additional items that are no longer exempt include:

- Nonessential packaging items related to sales of food and beverages.
- Energy used for industrial and other related purposes.
- Standardized computer software.
- Agricultural compounds and pesticides.
- Materials used in direct mail advertising.
- Sales by out-of-state retailers



There are more than 15,000 taxing jurisdictions in the U.S. and Canada. Sage Sales Tax by Avalara provides an interactive tool to get the correct rate for every one.

The situation in many other states and jurisdictions across the nation is similarly complex, requiring sellers of goods and services to stay abreast of such changes—as well as the boundaries of taxing jurisdictions in which they do business.

While the U.S. Postal Service has established ZIP codes for mail delivery, tax jurisdictions do not generally follow ZIP codes. In order to help businesses cope with these differences, providers of automated solutions continually research the physical boundaries of taxing jurisdictions nationwide. Without the use of geospatial technology, there is simply no way, in many cases, to accurately determine which jurisdiction applies to a transaction.

In addition to determining what products are taxed and where, retailers who do business across tax jurisdiction boundaries also must understand who must pay the tax and who is exempt. For example, if the product is sold to a government entity, including a Native American tribal government, it is generally not subject to sales tax. Nonprofit organizations are often exempt, and there are other exemptions as well. Often the difference simply depends upon the creativity of the individual legislature.

Another factor is whether a company has "nexus," or a physical location, in a local jurisdiction. If so, it must collect sales taxes. The retailer is the agent that the states use to collect sales and use taxes. Some states provide compensation to help cover the cost of collecting these taxes, and some do not. Many states provide a sales tax discount to vendors, but again, these rules vary widely.

Legislation Sparks Debate

To help simplify sales tax compliance and collection, the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL) in 1999 created the Streamlined Sales and Use Tax Project (SSTP). A key objective was to reduce the complexity in multistate tax issues—as well as to harness the potential of online sales as a source of tax revenue.

A Streamlined Sales Tax Agreement has been developed that is intended to minimize costs and administrative burdens on retailers that collect sales tax, particularly those operating in multiple states. It also encourages "remote sellers" selling over the Internet and by mail order to collect tax on sales to customers living in the states that have signed on to the agreement.

Forty-four states have concurred with the agreement, and 23, representing 33% of the nation's population, have passed conforming legislation. On January 1, 2011, Georgia joined that list, bringing the total to 24. In addition, conforming legislation is pending in ten other states.

"Sales tax administration through the SSTP is improved through tax law simplification, more efficient administrative procedures, and emerging technologies," said Scott Peterson, SSTP executive director.

Advocates of the SSTP contend that local brick-and-mortar stores operate at a competitive disadvantage with remote sellers who do not collect or pay sales and use tax. Local stores, they say, serve as "showrooms" for Internet and catalog sellers, with customers' checking out merchandise locally but purchasing it online to avoid paying sales tax.

But Peterson said the SSTP changes that. "Brick-and-mortar retailers benefit from the simplified and uniform measures as well as from not having to compete with people outside the state where the sales tax differential exists," he noted. "They can compete on the basis of something other than sales tax."

The heart of that issue is the 1992 U.S. Supreme Court decision in Quill vs. North Dakota, which found that a state cannot require a seller to collect sales tax on sales made to buyers in that state unless that seller has a physical presence in the state. To change this finding, Congress must change the law.

Meanwhile, 1,200 retailers currently collect sales tax in "Streamlined States" under a voluntary system. Those 1,200 retailers have collected more than $468 million in sales tax from those states, but advocates point out that this is a small fraction of potential sales tax collections. Some studies estimate that by 2012, states could be unintentionally forfeiting as much as $23 billion per year in uncollected sales taxes.

What, Where, and Who?

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E-Retailers Resist Compliance

An early argument used by Internet sellers was that the complexity of sales tax laws across the nation made it impossible for them to comply and that as a fledgling industry, they should not have the additional burden of sales tax compliance.

"But today, that is a huge red herring," contends James Dion, founder and president of Dionco, Inc., a Chicago-based retail consultancy. "The time has come for the Internet retailers to compete fairly and stop using the complexity issue as a way to avoid sales tax compliance responsibility. They have had the chance to get a toehold, and now the revenue being lost by municipal and state governments is staggering."

However, Stephen McGonegal, an associate at Econometrics, Inc. in Bethesda, Maryland, argues that states that do not participate in the SSTP would benefit from the migration of Internet shoppers that would switch to making their purchases from companies in nonparticipating states in order to avoid paying the sales tax.

In a study he coauthored when he was president of Independent Analysis Inc., McGonegal argued that while states participating in the SSTP would increase their sales tax receipts by about $4.8 billion, about $29 billion in sales would shift to zero-sales-tax states, and so the tax revenue on those sales would be lost.

However, he agrees today that if Congress passes a uniform law that would end "migration out of the regulated zone," the lost sales and taxes would be reduced. Still, there are currently five states that do not charge sales taxes: Alaska, Delaware, Montana, New Hampshire, and Oregon, and they could benefit, he said.

Dion pointed out that large brick-and-mortar retailers with stores in all 50 states and U.S. territories have "figured it out." "Their Point of Sale (POS) registers, with the help of automated sales tax solutions, know exactly what tax to collect and where it needs to be remitted," he said. The SSTP is a "great way of short- skirting the complexity issue," Dion agreed.

Automated Solutions Simplify Tax Compliance

Attempting to keep track of the constantly changing state tax situation manually can be overwhelming for any business. But automated solutions can help companies meet those statutory tax requirements, and at a very reasonable cost.

Technology solutions are helping businesses by taking the manual monitoring and updating out of their hands. These solutions can literally monitor tens of thousands of taxing jurisdictions and provide licensed users and on-demand sales tax management clients with up-to-date rate and boundary information on a regularly scheduled basis.

A number of solution providers have been certified by the Streamlined Sales and Use Tax Project (SSTP) to provide assistance to businesses that sell in multiple states.

Automated Technologies Provide Compliance Assistance

Under the Streamlined Sales Tax Agreement, companies doing online business nationally would be responsible for collecting and filing tax returns in all jurisdictions where they have sales. To deal with that problem, the SSTP has contracted with and certified several companies to provide software assistance. Retailers that use those providers will be held harmless in the event of mistakes in calculation.

Limited audit liability protection is one of the many benefits of the Streamlined Sales Tax Project, provided the seller uses a Certified Service Provider (CSP). The CSP works with state auditors to resolve audit issues before the customer is involved.

"The time has come where the Internet retailers are going to have to compete fairly and can't use the complexity issue as a way to avoid this responsibility."

—James Dion, president, Dionco, Inc.

Meanwhile, legislation introduced in Congress in 2010, known as the Main Street Fairness Act, would allow states to collect sales tax for online purchases, implementing the Streamlined Sales Tax Agreement and, thus, helping to simplify the tax collection process for participating states.

“This bill would create a level playing field between online merchants and local stores while ensuring that state and local governments can collect the sales tax revenue they need to support vital services like police and fire departments, ambulances, and schools,” explained NRF Vice President and Government and Industry Relations Counsel Maureen Riehl.

But Internet sellers are lined up against the bill and can be expected to flex their muscles. The Direct Marketing Association (DMA) filed a federal lawsuit against the state of Colorado for its Internet sales tax law, contending it is unconstitutional and a violation of consumers’ privacy.

Amazon.com and eBay are leading opponents. Brian Bieron, senior director, Federal Government Relations and Global Public Policy at eBay, said the measure would “undermine small business retailers that use the Internet.” Amazon.com is fighting the matter in court. In early November 2010, a New York appeals court reinstated Amazon.com and Overstock.com’s lawsuit claiming a state law forcing them to collect sales taxes is unconstitutional.

Lawsuits

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Sales Tax Complexities Simplified

Clearly, the companies that sell products across tax jurisdictional lines face a complex web of requirements that is constantly evolving. As indicated by the SSTP, technology solutions exist to help address these issues and difficulties, and several companies have been certified under the SSTP to provide the necessary assistance quickly and easily.

A CSP is designed to allow a business to outsource its sales tax administration function. The software system of a CSP knows what products and services are taxable, the tax rate at which they are taxable, can interface with the retailer’s accounting, financial, POS, and e-commerce system, and a few will also file the tax return and remit the tax on the retailer’s behalf.

There are a number of companies certified to provide these services, including Sage Sales Tax by Avalara, which offers a fully automated, end-to-end sales tax solution that provides customers with the most up-to-date and reliable taxability rules, jurisdictional assignments, and sales tax rates. And because the Sage Sales Tax service is completely web-based, the service captures transactions in real-time and therefore provides completely accurate sales tax calculations.

Conclusion

Businesses across the nation face a complex web of sales tax requirements resulting from differing rates, standards, and requirements in some 15,000 taxing jurisdictions that range from states to individual companies.

At the same time, there is unfairness at work—with Internet sellers generally able to avoid collecting and paying sales taxes on the products they sell, creating an unfair competitive advantage over brick-and-mortar retailers that must collect those taxes to support state and local infrastructure.

There is a broad, national effort to rectify this situation—the Streamlined Sales Tax Project, to make the rules of the road more uniform nationally while still allowing local jurisdictions the power to establish their own sales taxes as they choose. That project also has a goal of achieving competitive equity for businesses on Main Street by ending the free tax ride currently enjoyed by online retailers.

Retailers, both those on Main Street and those online, need help in staying abreast of the hundreds, even thousands, of varying tax requirements that they face, especially if they serve a multistate customer base. The SST project has approved a number of technology companies to provide this assistance.

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Sage Sales Tax by Avalara,
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About Sage

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