THE
5 STEPS
TO MANAGING SALES TAX

Choosing the right tax automation solution for your business

Avalara
Tax compliance done right
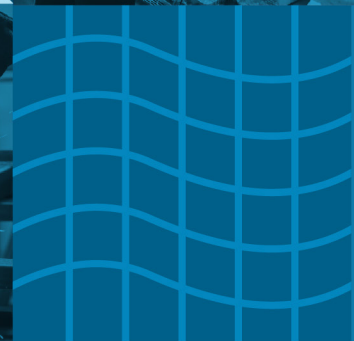
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DISCLAIMER

Tax rates, rules, and regulations change frequently. Although we hope you'll find this information helpful, this report is for informational purposes only and does not provide legal or tax advice.

Introduction

In theory, sales tax compliance should be a basic business task – a check box on a long list of must-dos. In reality, it's tedious, time-consuming, and (often) mind-bogglingly complicated. And as businesses explore more ways to attract customers and increase sales, compliance is only getting more difficult, which is true whether you're a start-up, a household brand, or a legacy company.

Simply put, there is no way to stay on top of tax compliance without technology. Automating sales tax management with software specifically designed to handle this work for you is a cost-effective solution; according to an Avalara/Potentiate survey, businesses with 20–499 employees estimate spending an average of $1,740 per month identifying state sales tax obligations and filing requirements. You can also save your team the time and hassle of manually researching tax changes and updating spreadsheets, not to mention automation can minimize the risk that comes along with human error.

Sales tax can be complicated, but finding the right tax solution fit for your business doesn't have to be. It all starts with having a complete picture of compliance.

THE FIVE STEPS TO MANAGING SALES TAX:

Step 1. Be clear on your tax obligations

Step 2. Register to collect and remit sales tax

Step 3. Determine your taxability

Step 4. Calculate the correct tax

Step 5. Remit sales tax and file returns

Step 1: Be clear on your tax obligations

WHY THIS STEP IS IMPORTANT

Sales tax compliance starts with nexus: knowing where you need to collect and remit sales tax based on your business activities within a state or tax jurisdiction. It's key to understand where you have nexus now, and also where you could trigger it in the future. You should also be clear on whether you have sales tax obligations based on physical presence nexus, economic nexus, or both.

In the U.S. there's no one standard for nexus, every state sets its own rules and thresholds. And these can be vastly different based on where you sell, what you sell, and who you sell to – particularly if ecommerce and marketplaces are part of your sales strategy. Certain states may also include exempt sales in their economic nexus thresholds, which means you could still need to file a $0 tax return, even if you don't collect tax.

For example, Georgia's nexus threshold is $100,000 in revenue or 200 transactions on the sale of taxable goods. This includes exempt sales of taxable goods, but excludes taxable services, exempt services, and exempt sales for resale. Whereas Mississippi's economic nexus threshold is $250,000 in revenue (no provision for number of transactions) and includes taxable goods, taxable services, exempt sales, and exempt services. In Alabama, the economic nexus threshold is also $250,000 in sales only, which includes tax-exempt sales and also sales made through a non-collecting marketplace but excludes sales made through a registered marketplace facilitator, exempt wholesale sales, and exempt services.

WHERE PROBLEMS CAN OCCUR

As your business changes, your tax obligations will likely change too. And if you aren't accounting for those changes, you could run into trouble with tax authorities or auditors. Small shifts in your business – an influx of new customers, more marketplace sales, using drop shippers, subscription sales, selling direct to consumers – could be the tipping point to nexus in more states. It's a lot to manage and changes happen frequently. This can inadvertently cause errors and oversights, which could prove costly to your business.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Relying solely on people resources (internal or outsourced) to track and manage nexus simply isn't efficient. You can't expect (or afford) them to be experts on every state's tax rules, regulations, and thresholds, or to constantly monitor when your company's sales could trigger nexus in a new state. But you can arm them with technology that will do all that – and more.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara AvaTax: Tracks sales activity and sends alerts when you're approaching nexus thresholds

ADDITIONAL SERVICES TO CONSIDER

- Sales tax risk assessment: Choose from basic and full assessments depending on your needs

WHAT CAN AFFECT NEXUS:

- Physical location
- Warehouse inventory
- Remote employees
- Affiliate relationships
- Ecommerce and marketplace sales
- Tax-exempt customers and sales

Step 2: Register to collect and remit sales tax

WHY THIS STEP IS IMPORTANT

Understanding where and how you need to register and which business licenses, forms, and registrations you need to complete before you can begin to collect and remit sales tax is tedious, but key. It's actually illegal to collect sales tax until your business is properly registered; so it's important to complete this step to avoid fines or risk having to cease operations.

You may have to register for several licenses depending on your business. Aside from a business license, you may need to obtain professional licenses or vehicle licenses. You'll also need to manage contracts if you're a service-oriented business, leases for your offices and warehouses, and more. For example, owning a convenience store can result in some inconvenient tax obligations. Because of the variety of products that you sell, you'll have to register for sales and use tax for household goods and certain types of food, excise tax for items like tobacco and fuel, and sometimes even consumer use tax.

WHERE PROBLEMS CAN OCCUR

You'll find out quickly that the processes, forms, and registration requirements differ from state to state (and sometimes jurisdictions within a state), so there's no simple way to manually register. And getting it wrong or operating without a business license can be a costly mistake.

WHAT AUTOMATION OFFERS YOUR BUSINESS

There comes a point when your filing cabinets and spreadsheets just won't cut it anymore. Consider a cloud-based license management solution that can register you to collect and remit sales tax, obtain the licenses you need, and manage your license portfolio in one place.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara Business Licenses: Reduces the complexity of managing license requirements

ADDITIONAL SERVICES TO CONSIDER

- Avalara License Guidance and Preparation: Determines which business licenses your business requires

Important: If you discovered in step 1 that you have nexus in a state but haven't registered to pay tax, you have a few more steps to complete. Make sure you backfile unpaid taxes or participate in a voluntary disclosure agreement (VDA), if required, *before* you register to collect and remit taxes. Learn more.

> **Marketplace selling.** If you sell online through a marketplace like Amazon, Etsy, or Walmart, those platforms may be collecting sales tax on your behalf. Nearly every state that has sales tax has marketplace facilitator laws on the books. These laws vary by state, but essentially they require the marketplace facilitator to collect tax on behalf of the seller. Make sure you know the laws in your state, including non-collecting seller use tax notice and reporting laws that require sellers to notify customers about their potential use tax liability, so you don't end up collecting and remitting the incorrect amount of tax.

Step 3: Determine your taxability

WHY THIS STEP IS IMPORTANT

It's imperative that you know the taxability of the goods or services that you buy, sell, and use. Not all products are taxed the same way across jurisdictions, and even within jurisdictions rates and rules can get complicated.

For example, say you run a bakery in Texas. Ready-to-eat food, like a croissant served in a pastry bag with a plastic knife included, is typically taxable when sold to go. But if you sell the same item without a plate or eating utensils, it is not taxable. If you give a free pie to your best customer, it is not taxable, but the complimentary soda you include with it *is* taxable.

Software taxability is also tricky; in many states, digital audio files like music and podcasts, digital books, games, and streaming services are taxed differently. Some states, like Alabama, tax digital products, while some states like Georgia and Missouri exempt digital goods and services from sales tax. There are also states like Michigan and Kansas that tax digital games, yet exempt other digital products. Get the download in our latest state-by-state guide to the taxability of digital products.

WHERE PROBLEMS CAN OCCUR

With so many different tax and taxability rates to keep track of, it can be easy to get it wrong. What's taxed at one rate in one state may be taxed at another rate in a different state or even in another jurisdiction within the same state. In some states, those same products or services could be tax-exempt or partially taxed. This is commonly the case with food, apparel and footwear, books, and sporting goods, among others. Who you sell to and how you sell it can also impact taxability. For example, if you sell to businesses and consumers or offer your products in both a physical and digital format.

If you have tax-exempt customers, you need to consider how you're tracking, managing, and storing exemption certificates. Failure to produce accurate records can result in noncompliance and fines if you're audited.

WHAT AUTOMATION OFFERS YOUR BUSINESS

The inconstant nature of sales tax makes compliance onerous. Which is why so many businesses employ technology to do this work. Avalara software comes with a powerful tax engine and vast tax content library with regularly updated tax rates and taxability rules. Tax automation with Avalara also helps

you monitor changes to taxability, track and store exemption certificates, and keep tidy records in the event of an audit.

WHICH SOLUTIONS ADDRESS THIS STEP
- Avalara Exemption Certificate Management: Makes it easier to collect and manage exemption certificates
- Avalara MatrixMaster: Tracks product taxability with the world's largest database of UPC codes
- Avalara Consumer Use: Automates use tax compliance

ADDITIONAL SERVICES TO CONSIDER
- Avalara Tax Research: Find answers to your trickiest tax questions quickly and easily

Use tax. It's one of the more complex compliance issues. Unlike sales tax, the seller of an item does not collect tax, and instead the responsibility to pay it shifts to the buyer. Learn more about use tax liability and compliance solutions.

Step 4: Calculate the correct tax

WHY THIS STEP IS IMPORTANT

Get your calculator ready – it's time to calculate sales tax! There are more than 13,000 sales and use tax jurisdictions in the United States, and each one has different rates and taxability rules. Depending on the types of goods and services your business deals with, you could be determining rates and calculating sales tax for a while.

You should understand which variables make up a tax rate, like tax jurisdictions and product taxability, and then put a plan in place to monitor and apply the most up-to-date tax rates on your transactions. Failure to calculate the correct tax can result in you overcharging or undercharging your customers, and having to answer for the difference in penalties. If your company sells something that is a combination of goods and software, like a smart thermostat that you can control from your phone, you'll have to take into account different types of tax. Things can get especially tricky if your item uses or contains software, software as a service (SaaS), streaming video, or downloaded media since each state defines and taxes software in different ways.

WHERE PROBLEMS CAN OCCUR

If your buyers are in another state, their tax rates are likely different from yours. Ecommerce sales charge the tax rate based on where the items are shipped to, not where they're shipped from.

WHAT AUTOMATION OFFERS YOUR BUSINESS

No more downloading rate tables or combing through state websites. With automated tax calculation, tax rates are instantly applied to every transaction, taking into consideration item taxability rules and exemptions. Get alerts when you're at or about to exceed nexus thresholds. Address validation software pinpoints where the sale originated and applies the applicable tax amounts at checkout. This makes multistate sellers and cross-border sales much easier to get right, resulting in more accurate calculations and happier customers.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara AvaTax: Calculates sales tax across industries, borders, and tax types

ADDITIONAL SERVICES TO CONSIDER

- Avalara Tax Research: Provides answers to your trickiest tax questions quickly and easily

Sales tax holidays. Everyone likes saving a few dollars at checkout, but sales tax events where normally taxable products are exempt from sales tax can make taxes more complicated for businesses. Approximately 17 states have one or more sales tax holidays each year, and new ones are enacted all the time. Make sure you know when your state is offering exemptions on items like back-to-school supplies and clothing, disaster preparedness gear, energy-efficient products, and more.

Step 5: Remit sales tax and file returns

WHY THIS STEP IS IMPORTANT

So you've determined your nexus obligations and taxability, registered to collect and remit tax in the appropriate jurisdictions, and created a detailed calendar of state sales tax holidays. Now it's time to remit sales tax and file returns.

Each tax authority has their own regulations and forms around sales tax remittance, including due dates, format (paper or electronic filing, which is becoming increasingly popular), and frequency. In most states, you should remit taxes to a state agency that then distributes the tax dollars to local agencies. But in some states, like Alabama, Colorado, and Louisiana, you'll have to register and file with those local agencies too.

WHERE PROBLEMS CAN OCCUR

You may have multiple deadlines to track, with different filing requirements for each jurisdiction. Failure to remit taxes on time can result in fines, and failure to remit altogether can result in jail time.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Making sure you understand the filing requirements for each jurisdiction where you collect tax and have a plan to file those returns when they're due can be a time-consuming and labor-intensive process. An automated solution can keep track of due dates and file for you, and even track economic nexus.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara Returns: Automates sales tax returns, including preparation, filing, and remittance

ADDITIONAL SERVICES TO CONSIDER

- Streamlined Sales Tax: Covers the cost of using a tax compliance solution like Avalara in some states and for qualified businesses

Zero returns. Your business may be required to file a zero return, also known as a $0 return, even if you don't have any taxable sales to report during a filing period. This includes tax-exempt sales where sales tax wasn't collected if those sales were made in states that include exempt sales in their economic nexus thresholds.

A lot goes into getting (or staying) tax compliant. From changing legislation to tricky taxation scenarios to different regulations across states, it can quickly become overwhelming. But if you have the right tools and resources, it doesn't have to be.

AVALARA CAN HELP

Know Your Nexus ebook

Nexus resource hub

Sales tax registration 101

Business licenses 101

Sales tax laws by state

Sales tax calculator and tax rate lookup tool

5 Steps to Managing Sales Tax Compliance for Exempt Sellers

How to manage exempt online sales

A complete tax compliance solution built for how you do business

At Avalara, we live and breathe tax compliance. That means that we have solutions to help you determine nexus obligations, register, calculate sales tax, manage exempt sales, and file and remit your returns – saving you time and hassle.

Learn about the Avalara suite of products that can help simplify compliance.

Avalara AvaTax
Apply sales and use tax calculations

Avalara Business Licenses
Manage licenses in a secure database

Avalara e-Invoicing
Automate finance operations; comply with e-invoicing mandates abroad

Avalara Exemption Certificate Management
Collect, store, and manage documents

Avalara Returns
Prepare, file, and remit sales tax returns

Avalara Tax Research
Get tax research in plain language

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