Taking your business in a new direction

How adding products and sales channels changes the course of sales tax

In its first years doing business, direct-selling cosmetics powerhouse Avon consisted of one man selling books door to door. Toy giant Hasbro got its start selling textile remnants and, later, school supplies. The Marriott hotel empire grew from a single Washington, D.C., root beer stand to a lodging and hospitality titan, while Samsung evolved from a noodle exporter into one of the world's leading electronics manufacturers.

Avalara
Tax compliance done right

Whitepaper

Change is a natural part of growth for smart businesses. But venturing into new sales channels and selling new products can have unintended consequences – and may even put your tax compliance efforts in jeopardy. While sales and use tax may not be top of mind when adding products and sales channels, compliance failures present a significant source of risk for growing companies.

This paper explores how shifting products and sales channels can impact tax compliance – as well as best practices to successfully navigate these changes while minimizing risk.

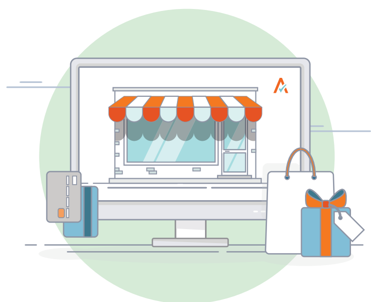
Product Taxability

Venturing into new product categories can create major opportunities, whether your business is new or well-established. Odds are, sales taxability isn't the first thing you think of when adding products, but it needs to be on your mind to avoid facing audit risk.

For example, let's say your company sells electronic devices online and through brick-and-mortar stores. After a few years of successful growth, you decide to start offering optional extended warranties to your customers. California customers won't be subject to tax on the extended warranties, but Washington customers will – and while they may be exempt from extended warranty sales tax in Wyoming, they won't be unless the warranty is purchased separately from the device itself.

With different taxability rules in different states and local tax districts, tracking taxability changes can get tough. Sellers of food products often find that even small changes to a product lineup – or even the ingredients in a particular recipe – can impact taxability. Adding flour to the recipe for a dessert bar changes it from a taxable candy to a tax-exempt food product in states like New Jersey and Washington.

For sellers of digital goods, the taxability landscape is even more challenging. Software companies will find that their digital downloads are taxed differently from sales of physical discs containing software, and that taxability can differ for custom-built and prebuilt software.



Online and Offline Expansion

Sometimes, *how* you sell can create even more sales tax challenges than *what* you sell. When your growth plan includes incorporating new sales channels, it's imperative to understand the impact your new strategies may have on tax compliance.

One of the most common situations for businesses today: selling online through ecommerce sites or marketplaces. If your business has previously sold products at physical locations, it's likely that your tax compliance strategy involved staying up to date with rule changes only in the states and local tax districts where your retail stores were located. Once you start selling online, depending on whether your connection with other states is strong enough to require you to collect tax on remote sales, you may have to collect and remit tax in hundreds – or thousands – of different jurisdictions.

Although physical presence nexus still exists, sales tax nexus can now be established solely through economic ties to a state, or economic nexus. Since it became legally allowable to do so following the June 2018 Supreme Court decision in South Dakota v. Wayfair, Inc., all but two of the 45 states with a state sales tax have adopted economic nexus. Laws and thresholds vary by state, which can make compliance exponentially difficult if you have to register to collect and remit sales tax in more states. Additionally, 36 states have marketplace facilitator laws related to ecommerce selling.

For some ecommerce retailers, the final growth frontier is that most old-fashioned of sales channels: a brick-and-mortar store. Several well-known pure play ecommerce brands have opened physical stores in recent years including ModCloth, Allbirds, Casper, and Warby Parker. The most notable of course being Amazon, which launched its first physical bookstore in Seattle in 2015 followed by its cashierless Amazon Go grocery stores.

"Blended retail" aims to capitalize on consumers' multichannel shopping habits – connecting the online and in-store experience. But this business model comes with its own sales tax complexities – from the headache of appropriately refunding sales tax on returns of online purchases made in-store to integrating information from point-of-sale systems and ecommerce software.

Product and services taxes also vary by state, which adds yet another layer of complexity and risk.

[1] Deloitte

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Shipping, Franchising, and Trade Shows

Millions of businesses have already started using Fulfillment by Amazon (FBA) to simplify complex sales and distribution challenges. However, because FBA works as a drop-shipping program, using warehouse space in several locations to make distribution faster, using FBA can generate nexus in multiple states.

For a seller who previously had nexus in just one state, this adds a potentially difficult layer of bureaucratic requirements for sales tax registration, calculation, and filing. Keeping up with changes to sales tax rates and taxability of each product you sell becomes even more difficult as nexus is established in more jurisdictions.

Franchising is a great way to expand many businesses, but nexus can get complicated for both franchisors and franchisees – and so can exemption certificates, which need to be kept to prove that any non-retail transactions were correctly registered as tax exempt.

For many businesses, trade show attendance is one of the best ways to quickly expand a customer base and establish a brand. Many companies are totally unaware that in some states, like New York, selling a few products at a trade show could be enough to establish nexus – and an obligation to collect sales tax on all transactions to New Yorkers, even on purchases made over the phone or online.

Making a nexus mistake, even a seemingly small one, can be incredibly costly. The average company spends 37 days preparing for and dealing with an audit at a cost of around $300,000, according to Wakefield Research. Once mistakes are found, companies can expect more audits to come in a regular cycle, often looking over several years of past transactions (called the "lookback period") to investigate irregularities.

Just because auditors aren't knocking at a company's door doesn't mean the business is in the clear for sales tax enforcement. In some states, *qui tam* laws allow ordinary citizens, even those with no connection to the purchase of a product, to whistleblow on companies that haven't registered for or paid sales tax. Recent cases raised by whistleblower attorneys in New York and Illinois have cost businesses big: In one case, a pillow manufacturer who didn't realize trade show attendance established nexus was forced to pay over $1 million to settle a suit under New York's False Claims Act.

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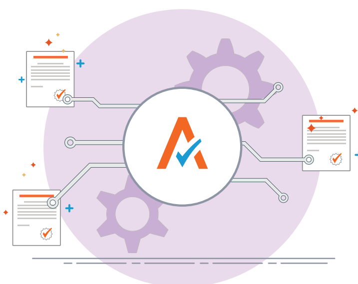
The right way to address nexus isn't to bury your head in the sand and hope it goes away – it's to conduct a nexus study regularly to ensure you're collecting and remitting tax in every jurisdiction where you've established nexus. Alternatively, some automated tax solutions like Avalara trigger an alert when the company establishes nexus in a new location.

Once you address the sales tax issues created by establishing nexus in new states, you can confidently move forward with growth plans.



Automation: Enabling Growth Without Growing Pains

No company wants to put a damper on its own growth because of fears about tax penalties and bureaucratic requirements. But every form of growth – even dipping a toe into a new sales channel – can result in additional compliance complexities.

Trying to scale up manual solutions to take exponentially-growing complexities into account is a losing battle. When companies try to keep using the same sales tax strategies that worked in earlier stages of growth, the result is spending more and more time on compliance efforts that are less and less effective.

For true scalability, there's only one real solution: automation. When you automate the sales tax process from end to end, growth – of either your product lines or your sales strategies – stops wrapping you up in red tape.

Avalara's cloud-based software-as-a-service (SaaS) solution is updated continuously to keep track of every sales tax rule change in the United States. End-to-end automation integrates into the software you already use, powering up your financial, ERP, ecommerce, and point of sale systems with automated rate calculation, push-button returns filing and payments, reporting, and document management that keeps you protected in the event of an audit.

For more information on how automation with Avalara can make your path to growth easier, visit avalara.com.

To learn more about Avalara's products, visit:

avalara.com

or call

877-811-7961

Avalara helps businesses of all sizes get tax compliance right. In partnership with leading ERP, accounting, ecommerce 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.