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EBOOK

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VERTEX SMB

5 Steps to Simplify Sales and Use Tax Processes

How SMB Retailers Can Tame the Complexities of Rapid Growth

Introduction

For any retail enterprise, from the smallest mom-and-pop store to the biggest multinational chain, managing sales and use tax can present formidable challenges. It's tough for small- to medium-size business (SMB) retailers that are taking advantage of expansion opportunities but don't yet have the manpower or the sophisticated financial systems to handle the expanded tax responsibilities that go along with their growth.

These retailers may find that in a race between rapidly increasing complexities of sales and use tax management and limited available internal resources, falling behind can have serious consequences — from incorrect collection or payment of tax to the very real possibility of an audit assessment by state or local tax agencies. For companies that rely on consumers' trust, such as SMB retailers that are well-known in their communities, these actions can do a lot of damage to the brand's reputation.

These issues are particularly acute for SMB retailers for three major reasons:

- **Consequences of Growth:** Expanding into new product offerings can quickly multiply the complexities of sales and use tax management. Taxation rules can vary widely even for similar product types; for example, when an apparel item is identified as a luxury item versus essential, or if food and beverage are sold by an eating establishment instead of a grocery store.
- **State-by-State Nuances:** Ecommerce and the use of third-party warehouse and fulfillment services simplify expansion to new markets but they can quickly complicate tax calculations, making it difficult to clarify exactly where nexus exists.
- **Audit by Automation:** States are more actively pursuing sales tax collections, using big data-style analytics and automated solutions, as well as employing third-party companies that are paid a percentage of taxes and fees collected.

Rate Your Tax Complexity: Self-Assessment Quiz

Sales and use tax complexity can change significantly even as the result of a relatively minor business decision. Adding a new product category, making an ecommerce sale to customers in a new state, or just using a third-party common carrier delivery service instead of its own trucks to fulfill orders can affect a retailer's responsibilities. That is why it is vital to establish a baseline of your current tax complexity and to revisit it on a regular basis.

Answering these six questions can help SMB retailers rate their current level of tax complexity. Each "yes" answer is worth 5 points. When you complete the quiz, see whether your business is ripe for tax automation help.

Yes No **1. Do you currently collect and remit sales or use tax?**

Yes No **2. Do you sell into more than two states?**

Yes No **3. Do you sell more than one type of product or service?**

Yes No **4. Are you manually researching and updating tax rates?**

Yes No **5. Have you completed a nexus questionnaire?**

Yes No **6. Have you previously been audited?**

Based on your responses, you've scored ____ points out of a possible 30.

(0 to 10 points): Low Complexity
Your company currently has its sales and use tax requirements under control. Revisit your complexity level every few months to assess your needs.

(15 to 20 points): Moderate Complexity
You may be spending more time researching rates and submitting returns than needed. Consider some form of automation such as a returns filing service.

(25 to 30 points): High Complexity
Given your requirements, you are now at a point where deploying tax automation makes sense for your business. Contact a solution provider to determine next steps.

To help SMB retailers face these challenges, this ebook will identify five steps companies can take to simplify their sales and use tax processes:

I. Navigate Sales Tax Rules Across Jurisdictions, State Lines, and International Borders

II. Simplify Calculations Even as Product Categories Multiply

III. Use an Automated Solution for Sales and Use Tax Returns

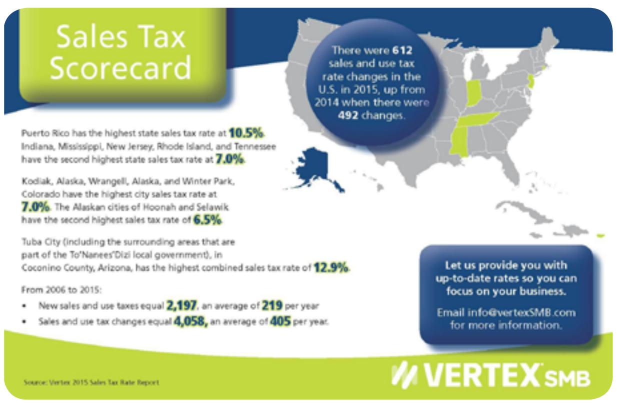
IV. Integrate Tax Data and Documentation

V. Access Analytics to Understand the Tax Implications of Business Decisions

In addition, this ebook includes top FAQs about tax management and tips for surviving a sales tax audit.

> "States are more actively pursuing sales tax collections, using big data-style analytics and automated solutions."

I. Navigate Sales Tax Rules Across Jurisdictions, State Lines, and International Borders



Sales Tax Scorecard (click to view entire image)

SMBs must keep abreast of the various sales and use tax rates and regulations wherever they operate. (The U.S. alone contains more than 10,000 tax jurisdictions.) The first step is to determine if the company has a requirement to collect sales or use tax. This is called "nexus" and refers to the presence a company may have with a particular jurisdiction, and it can be a topic of debate between the jurisdictions and the companies. Nexus is affected by factors such as whether a retailer uses its own trucks to deliver packages in a state, contracts with a third-party delivery service for fulfillment, or maintains a distribution center, just to name a few.

[For more information on what constitutes nexus, see sidebar: "Top 5 Questions about Tax Management for SMB Retailers"]

Rates are another issue: Some jurisdictions charge additional rates on top of the state's basic rate. Missouri, for example, has approximately 2,000 local tax rates. In most cases the rate is based on where the product is delivered, but there are still a few states that source local taxes on intrastate transactions back to where the sale originates.

These rates do not remain static. In fact, according to Vertex Inc., 2015 saw 612 sales and use tax rate changes in the U.S., up from 492 in 2014. From 2006 to 2015, the average annual rate has been 405 changes per year.

One tool that can be used to keep up with these changes is a product taxability report that provides state-by-state, jurisdiction-by-jurisdiction data on sales tax rates and taxability regulations. This report can be found within a sales and use tax automation solution and can be referenced with the click of a button. Without an automated solution, expansion into new markets could quickly overwhelm a company's capabilities.

Operating across international borders raises another host of tax management challenges that will accelerate with increased cross-border sales. **Forrester Research** projects that online B2C (business-to-consumer) sales will more than double in the next five years, reaching $424 billion by 2021. Growth will be strongest in developing markets such as China, with Latin America, Asia Pacific, Africa, and the Middle East expected to register double-digit compound annual growth during this period.

Top 5 Questions about Tax Management for SMB Retailers

If you are considering moving in the direction of an automated sales and use tax management solution, refer to these five FAQs for some basic information before you proceed.

1 I have multiple warehouses in one state, stores in multiple states, and I ship to all 50 states and Canada. Do I need to collect taxes in all of these locations?

Retailers are required to register for, collect, and remit sales tax for states and jurisdictions in which they have nexus. Because legislation is constantly changing, it's important to stay current and understand where your business has nexus.

2 What constitutes nexus?

What constitutes nexus varies by state and jurisdiction so it is important to seek the advice of your trusted tax advisor. Nexus is a sufficient physical presence and can include a number of different situations such as warehouses, stores, affiliates, or even salespeople. Some of the more common nexus criteria include:

- A physical presence/location, such as a store, office, or warehouse, just to name a few
- Solicitation by company sales representatives
- Company-owned vehicles delivering tangible personal property into the jurisdiction
- Company-owned tangible personal property, such as capital equipment or inventory, stored or located in the jurisdiction
- Out-of-state seller with no in-state physical presence but regular in-state activities such as training classes held in the jurisdiction
- Tangible personal property leased or rented to someone located in the jurisdiction
- Repair or maintenance of tangible personal property located in the jurisdiction

3 How much does an automated tax management solution cost? What are the advantages of a pay-as-you-go, consumption-based model?

Depending on the tax management solution that's chosen, there could be annual contracts requiring usage estimates, as well as upfront implementation fees. A consumption-based solution, where customers pay only for what they use, is a good fit for an SMB retailer because customers only pay for what they need, and the solution easily adjusts as their business scales up or down.

4 What do I need to have in place in order to implement a tax management solution for my business?

At the very least, retailers require a system that allows the organization to store a tax rate for locations of over-the-counter sales. Even better is a system that stores rates by individual inventory items, since each product sold could have distinct taxability.

5 What are the risks of continuing to manage my sales and use tax manually?

Without an advanced, automated system in place, retailers can suffer from increased audit exposure due to:

- Incorrectly managing product taxability resulting in under- or over-collection of tax dollars
- Increased risk of over- or underpayment of taxes
- Lack of access to the most up-to-date tax rates, rules, and forms across states and jurisdictions in the U.S. and Canada
- Not collecting and maintaining exemption certificates
- Filing incorrect returns or filing returns late or with inaccuracies

II. Simplify Calculations Even as Product Categories Multiply

All products are not created equal and which products are taxed at which rate often is a matter of geography. For example, candy bars, doughnuts, and sandwiches all are food items, but depending on the jurisdiction each might be subject to different sales tax rates or product taxability. Rates can also depend on whether food is consumed on the premises or carried out. For example, in New York one sliced bagel is considered a prepared food and subject to sales tax, but when purchased by the dozen, sliced bagels are exempt from sales tax.

Apparel can also be subject to an array of tax regulations. Some jurisdictions draw distinctions for taxation between apparel worn for everyday use like t-shirts and luxury items such as fur coats. There can even be tax variations between a pair of sneakers and athletic cleats.

As SMB retailers consider expanding their product offerings, an automated sales and use tax solution that's connected not only to localities but to product and service types can simplify calculations and keep the company compliant with taxability and rate changes that occur.

III. Use an Automated Solution for Sales and Use Tax Returns

Apart from determining if tax is owed and which items are taxable or exempt, the actual work of calculating sales and use taxes and filing the appropriate returns is both time- and labor-intensive.

Key steps include:

- Determining which jurisdictions require returns (i.e., where you have nexus)
- Identifying which forms to complete (sales tax only, use tax only, or a combined return)
- Completing the correct forms
- Filing on time (late or incorrect filing runs the risk of the assessment of penalties and interest and possibly an audit)

For some SMBs, an automated returns offering provides a time-saving solution. Those delivered via the cloud minimize a retailer's hardware investment and automate update processes. In addition, a cloud-based solution allows SMBs to import tax data from any financial system to generate accurate and compliant returns. Services that charge on a consumption basis allow a retailer to pay only for returns it prepares (or those prepared for it by the tax management service).

Tips for Retailers on Surviving a Sales Tax Audit

The best way to survive a tax audit is to avoid one in the first place. SMB retailers should learn the nine points of the **Sales Tax Compliance Checklist:**

1. Know your nexus
2. Maintain sales tax and business licenses
3. Know the tax rates
4. Understand product taxability rules
5. Recognize the difference between origin vs. destination based sales tax rules
6. Collect and maintain exemption certificates
7. Charge proper tax type
8. Know the risk on sales and use tax returns
9. Understand audit triggers

These audit triggers can include:

- A significant percentage of exempt sales
- Large changes (either increase or decrease) in sales tax
- Late returns filings
- Incorrect math

If an SMB retailer must submit to a **sales tax audit,** the auditor will usually ask for a list of nontaxable or exempt sales transactions; invoices and associated exemption certificates; and backup documentation. A **use tax audit** is similar: Auditors will request purchase invoices, use tax accrued and paid, and any direct pay permits.

Other documentation that will be needed:

- Chart of accounts
- Trial balance
- Nexus questionnaire
- List of locations
- Invoices
- Review of all exemption certificates
- Fixed asset purchases (use tax)
- Non-asset purchases (use tax)
- Review of all returns (federal, state, and local)

IV. Integrate Tax Data and Documentation

Often, simply gathering the internal data that is needed to calculate sales and use taxes represents a significant time investment. Systems including the point-of-sale (POS), general sales ledger, billing and ERP, as well as ecommerce all need to be tapped and the IT department is generally required. If the retailer keeps its brick-and-mortar and ecommerce sales separate, these sales must be aggregated if the business is registered as a single filing entity. However, sometimes sales tax needs to be reported by location. In addition, for retailers that sell through third-party marketplaces, these need to be integrated with sales from other channels.

SMB retailers can simplify both the data gathering and calculation parts of their processes with a centralized tax management system. This type of solution can handle data from multiple sources and in various formats, calculating the taxes owed and generating the appropriate returns for individual jurisdictions and due dates.

A centralized sales and use tax management solution also simplifies record-keeping, including key paperwork such as exemption certificates for non-taxable items or exempt customers and previously filed sales and use tax returns. The need for comprehensive record-keeping in case of an audit is more pressing than ever, given states' pursuit of sales and use tax revenue. "The desire for revenue has led states to more aggressively assert nexus over out-of-state corporations in both the income tax and the sales and use tax arenas," according to Bloomberg BNA's 16th Annual Survey of State Tax Departments, as stated in a May 2016 **Accounting Today** article.

The article also noted a range of states' recent challenges to the *Quill* decision that governs most nexus determinations, including Ohio's assertion of a theory of Internet nexus that would create taxable presence every time a retailer's web site is accessed by a customer in the state.

Using Fulfillment By Amazon (FBA)

SMB retailers that work with Amazon in order to take advantage of its fulfillment prowess need to be alert to the multiple sales tax implications involved. In some cases, partnering with the ecommerce giant can create nexus in areas where the retailer previously had no other presence.

- According to an April 2015 article in the **Nashville Business Journal**, the location of inventory alone can create sales tax nexus. So if an online retailer transfers inventory to an Amazon Fulfillment Center, it creates nexus and leads to potential sales tax responsibility for the retailer.
- Amazon has been expanding the number of its fulfillment centers and as of September 2016 has them located in 22 states, 20 of which collect sales taxes (New Hampshire and Delaware do not).
- While Amazon provides a Tax Collection Service to its Fulfilled by Amazon (FBA) retailers that charge and collect sales tax when ordered through the Amazon process, the retailer is responsible for the setup and maintenance of this service. Amazon charges a fee of the collected sales tax.
- Even **Amazon Locker**, the self-service delivery locations that allow customers to pick up and return items, establishes nexus in the states where they are located, all of which currently charge Amazon customers sales tax.

V. Access Analytics to Understand the Tax Implications of Business Decisions

Insights gained from sales and use tax engine analytics can inform the kinds of expansion an SMB retailer pursues.

For example, nexus in a particular state can be created if a retailer:

- Has a physical presence in the state (i.e., a brick-and-mortar store, warehouse, or inventory located in the state)
- Makes regular deliveries with its own vehicles into the state
- Has sales representatives located there

Having easy access to information such as taxability and transaction reports can help SMBs:

- Perform a reverse audit to ensure their products are taxed correctly
- Properly manage their exemption certificates
- Ensure all returns are correct and filed on time

For retailers considering international sales, having such data about the countries under consideration is even more vital given the stakes involved, which include higher shipping costs, language issues, dealing with foreign currencies, and importing and exporting regulations.

Conclusion: Tax Management Automation Closes the Resource Gap

At a time when states are eagerly pursuing every penny of tax revenue and ecommerce has vastly enhanced the ability of even a small retailer to sell to customers in new markets, the need for a solid sales and use tax management strategy has never been greater. SMB retailers want to pursue new avenues of growth, whether that involves reaching new consumers, expanding their product offerings, selling through new marketplaces, or some combination of all three. Yet each of these growth paths is accompanied by sales and use tax implications that an SMB retailer may not be equipped to handle.

Automated solutions that provide clear, easily-accessible data about what is taxable (and where); what the specific rates are; and which types of returns need to be filed can dramatically streamline tax calculation, preparation, and record-keeping for a growing company. Centralization and automation can also consolidate the data and records required if a company is subject to an audit.

In addition to saving time and making the most of what are sometimes limited internal resources, sales tax automation also provides SMB retailers with valuable business insights such as taxability reports, transaction details, and exemption certificate management. The tax implications of selling in a new state or country, or choosing whether to fulfill via Amazon, can become key factors in the decision-making process — helping companies find the route that will best serve them and their customers.

For more information:

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Vertex SMB, a business division of Vertex Inc., helps automate sales and use tax compliance for small to medium-sized businesses. By enabling calculations and returns in a single, cloud-based solution, offering flexible service levels and featuring attractive pay-as-you go pricing with no upfront fees, Vertex SMB meets the sales and use tax automation needs of growing businesses.

Vertex SMB is built upon Vertex Inc.'s more than 35 years of tax expertise and position as the leading provider of corporate tax software and services. With Vertex SMB, growing businesses can realize the benefits of performing sales and use tax processes on the most advanced calculation and returns software platform in the industry. The solution is available for use as a stand-alone solution or integrated directly with midmarket ERPs and ecommerce platforms.

From returns-only processing, tax calculations, and signature-ready PDF returns to outsourcing services that include returns filing and payment processing, Vertex SMB provides a proven and reliable solution for businesses looking to save time, effort, and risk associated with sales and use tax calculation, returns, remittance, and compliance.

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