Navigating the US Indirect Tax Map

European Businesses are a Long Way from Home

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The complexities of US tax mean that European companies entering the market face an enormous regulatory and compliance challenge. They need to make sure they're armed with help, advice and practical solutions. A background in European VAT is not going to help manage an expansion into the US. In fact, quite the opposite—assumptions can be a risky thing.

At its heart, VAT is a relatively simple tax—albeit one made tricky by the complexities of global trading, intricate supply chains, the subtleties of VAT Place of Supply rules and ever-increasing compliance requirements. In contrast, the US sales and use tax environment is hugely complex. It's a highly-sophisticated network of locations, rules, tax types, rates and exceptions, with hundreds of thousands of possible variations.

As in Europe, ignorance is no defence when a business contravenes US tax rules. And basic errors have countless possible implications, from a slew of potential fines to the failure of global corporate migration before it has even started. Even American companies frequently fall foul of the system, paying big penalties with interest.

Because of this, European businesses often find US tax work difficult. Many of their finance systems are just not designed to cope with the complexity without extra technological assistance. And migrating from Europe to the US is virtually impossible without third-party solutions to supplement what's already in place—regardless of the size of the business.

Given the considerable differences, it's essential to get advice and understand the technology that can help—before expansion begins.

Fifty States, Thousands of Variations

A union of 50 states? Sure. But part of the problem that faces European businesses is America's unique approach to decentralised government, which allows individual states, cities, counties, towns and even smaller areas, an unparalleled level of freedom in deciding their own taxation rules. This means that there are over 10,000 separate taxing jurisdictions, each with the potential power to raise taxes.

Some states vary their rates by city, county, or even street. And neighbouring addresses can have different tax rates with the boundaries rarely matching zip codes. Jurisdiction identification is a big challenge in the US.

And if a business is not operating in the right jurisdiction, then even having the right rates won't help and fines are almost inevitable.

Previously, solving this was a long and arduous job that was easier to get wrong than right. And while modern technology solutions make things far easier, by automatically translating street addresses into tax jurisdictions, location variances are just the start of the tax complexities businesses face. Indeed, rates are equally fraught with myriad differences that can quite easily cause big problems.

Taxing Complications

While US sales tax rates are generally lower than VAT rates, they can vary widely—going from less than 1% to over 10%. And state sales tax is often layered upon additional local sales taxes. For example, in Chicago, sales tax is 10.25%: 6.25% state, 1.25% city, 1.75% county and 1% regional transport authority.

These rates may also differ according to purchase value, with a vast array of thresholds and brackets. In Tennessee, consumers pay a sales tax of 7% on the first $1,600 of their purchases and an additional tax of 2.75% on the second $1,600. While in Texas, certain sales of electronic data are subject to tax, but only on 80% of the price. These 'basis' rules exist across the US and are wholly alien to those used to the world of VAT.

Forty-five states and the District of Columbia impose a sales tax on retail sales and some services. The bulk of their revenue is now generated from sales taxes, not income taxes.

Moving Tax Targets

A further layer to consider is how jurisdictions can change their tax rules at will, moving boundaries, raising or lowering rates, introducing permanent or temporary exemptions, and announcing regular or random tax holidays. The logic is local: hurricane-prone states offer tax breaks on plywood and nails; hunt-loving states offer reprieves to buyers of guns and ammunition. Meaning that even if a retailer understands the tax landscape today, significant changes would almost certainly be in place by tomorrow.

Like with VAT, in the US different items may be taxed at different rates. But unlike with VAT, US classifications and exemptions depend not only on the state in which the customer is based but their exact location. In New York, for instance, various items of clothing are exempt from state sales tax (unless that item is more than $110) but subject to local sales tax.

Unfortunately for businesses that fall foul of the tax rules, it's not only the authorities who'll see it. In Europe, VAT is generally included in the price to a consumer. But if you've ever visited the US, you'll know that sales tax is very visible, literally added on at the till or an e-commerce check-out. Get the tax wrong and the customer will see it and be able to challenge. Retailers in particular do not want the customer experience to be blighted (or worse, abandoned) by charging too much tax or credit errors. So, it's important to get some help.

NOMAD states – New Hampshire, Oregon, Montana, Alaska and Delaware – do not collect sales tax. However, municipalities in Alaska can charge local sales taxes.

Stay Honest with Local Knowledge

Just as it's a bad idea to visit a new country without a guidebook, it's inadvisable to start doing business in new region without a bit of local knowledge. In tax, this equates to experience, advice and expertise from people who have been there, done it, and know how to successfully introduce a business to the US and keep it there.

Naturally, there are several areas in which local knowledge can make a big difference to how well a business migrates and integrates. However, the most prominent are nexus, exemptions and returns.

No Nexus, No Taxes

Nexus is essentially the label that indicates a business is liable to pay tax in a given location. On the most basic level, if a business has nexus in a state or jurisdiction, it must collect tax on sales taking place there.

As revenue from property taxes dwindled during the Great Depression in the 1930s, US states began to impose transactional taxes on goods and services.

It is a completely different concept to VAT registration in Europe, because it's not just acquired by a business filling out a form before making that first sale. Instead, Nexus can also be gained through a temporary or permanent presence of people (employees, service people or independent sales/service agents) or property (inventory, offices, warehouses). It even includes sales visits and trade show attendance. And once a business gains nexus in a state, it has it for life and all future sales to that state will be taxed.

A big part of the problem for European companies is that nexus rules are set by individual states, and every state defines them differently. Similarly, state legislators under pressure from budget cuts are liable to avoid imposing new taxes by manipulating rates and rules to generate revenue. So even when a business has nexus and knows about it, the ground could quite easily shift beneath its feet.

Nexus issues add to regulatory compliance. And they make entering the US market even more complicated, because businesses may unwittingly acquire nexus in a state, be liable to pay local tax and—without knowing their obligations – incur penalties. Really, the only way to guard against this is to know what to look for in an alien environment. Usually by having indirect tax people close to the business and local knowledge throughout.

Not Everyone Pays

As with nexus, understanding exemptions on tax without local knowledge is like trying to drive around a new area without a map. European know-how doesn't have a lot of use in US tax exemptions. Not least because sales to business customers, who plan to resell purchased items, can be exempt from sales tax—provided the customer produces a valid sales exemption certificate. Tax exemptions like these also exist for a range of customer types, ranging from government agencies to fishermen to schools.

Suffice to say, each state has its own take on where exemptions can apply and what constitutes a valid certificate type. And while suppliers are relieved from calculating the tax, they must implement appropriate certificate management structures to control the compliance of potentially thousands of these documents.

Put simply, it is absolutely vital to be clear on whether a purchase is liable for tax. If a business could have resold a product tax exempt but didn't have the necessary processes in place, the business will take the hit—not the government. And with no recoverable input tax in the US, when a company is charged sales tax it's a pure cost to them.

Similarly, inter-state transactions can trigger a requirement for a business to self-accrue a Consumers Use Tax. This type of tax is subject to all the complexity of other sales taxes, but with a range of specific exceptions for manufacturers. Again, Consumers Use Tax is a pure cost. And those unprepared for it will soon find the tax authorities very keen to check out-of-state purchases.

Keen not to lose out on revenue from international trade, state authorities have recently fought to close loopholes and expand the definition of nexus to include international online retailers, affiliate marketers, web advertisers and third party outsource partners.

No Return on Returns

Getting tax accrual right is undeniably essential. But businesses should never underestimate the final challenge—submitting returns, making payments and defending their numbers in tax audits.

Each month, returns are due at state level and potentially at local levels as well. The result of which is hundreds of submissions each month, thousands over the course of the year. And it's a huge task to keep up with the rules and rates, as well as state regulations.

As with nexus and exemptions, it's incredibly tough to do (some would even say impossible) without the right level of knowledge, skills, experience, due diligence and planning. Not forgetting, of course, technology.

Complicated to Automated

While the flexibility in the system serves US state authorities well, it's particularly bewildering for those coming in from overseas. With thousands of taxing jurisdictions, manually establishing nexus can be a significant drain on resource. And that's before anyone has considered the accurate collection, record-keeping and timely remittance of money.

To be compliant with US sales tax, not only do businesses need to be on top of the latest regulations, rates and classifications, they also need to set up processes for collecting tax at the point of sale and remitting it to the authorities via the appropriate channels.

The consequences of getting it wrong are huge. And collecting too much tax—raising prices—can be as damaging as collecting too little. US states are increasingly interested in overseas sellers and carry out regular tax audits, which can result in stiff penalties as well as backdated interest. A lack of understanding is no defence, and unwitting mistakes are as costly as deliberate tax avoidance. Put simply, for successful entry into the US, businesses must take advice where they can get it and use technology to make their tax work easier.

Do as the Americans Do

When entering the US market, it's easy for a European business to stop and think: 'How do I manage all this complexity?'

Fortunately, the answer is as simple as the tax regulations are complicated. And the basic answer is to follow the leaders and do as the Americans do. Today in the United States, the use of automated tax compliance solutions is commonplace, as business owners look to mitigate labour-intensive processes, reduce risk and save money. Largely this is because providers of automated solutions continually verify the ever-changing physical boundaries of tax jurisdictions using geospatial technology, offering peace of mind in a way that manual checks cannot. And they give businesses solutions that cater for every step of the tax lifecycle—from jurisdiction identification to tax determination and compliance.

The Tax Jigsaw

Due to its numerous parts and complexity, it can help to think of US tax as a jigsaw puzzle—a particularly complex one, to which most European businesses have no guide or picture to work to. Then to think of how they would go about trying to solve it: either taking all the pieces out of the box and seeing what they can do without any semblence of understanding of how they fit together; or looking for help wherever they can find it.

A tax performance engine is a central place that contains the most current, accurate and validated financial data for all tax types for current and earlier periods. It can also collect, organise and optimise data from multiple systems.

Big problems lie ahead for fortune-seeking business owners that take the first option, presuming that they can move into US markets with only a working knowledge of Europe's VAT system. But for those who have studied the land, sized up the challenges, taken sound advice and made adequate technological preparations, the opportunities and rewards of expansion are there for the taking.

Top Tips and Recommendations for European Businesses Going into the US

1. **Do your homework** – Ensure tax expertise is close to the business, know what, where and when the company is planning ahead of time, so you can be prepared for the challenges that lie ahead.
2. **Seek local knowledge** – Tax accountants trained in Europe are unlikely to have the knowledge base required to manage US rules. Seek local knowledge before making a sale.
3. **Use automation** – With so many laws, variations and legislative loopholes, trying to do everything with a spreadsheet and desk research makes no sense. Use automated systems such as a tax performance engine wherever possible to keep compliant in the US.

How to Find the Right Help

When looking for a technology partner, it's essential to ask the right questions. For instance, how many implementations have they done? Do they have extensive experience with your ERP platform? It's also worth finding out which systems industry peers are using to determine the best fit. And asking an ERP vendor for their recommendation, as well as discovering the research capabilities of potential tax automation vendors. Each of these will be critical to ensuring a tax system is always up to date with latest rules and rates. And to succeeding in a competitive, complicated environment.

To learn more, visit: **https://www.vertexinc.com/solutions/indirect-tax-solutions**.

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