



# Get Ready for Returnuary!

8 Ways Tax Affects  
Holiday Gift Returns



When all the holiday treats are eaten and the wrapping paper is discarded, shoppers will partake in another holiday tradition, returns. Given the surge in eCommerce, retailers are bracing for more returns than ever, dubbing the beginning of the year “Returnuary”.

As a retailer you it’s important to prepare for this imminent influx by making sure your business has the tax tools and resources to facilitate smooth returns for customers. This eBook is a guide to help you to better understand eight ways returns increase tax complexity including:

- 1. Shoppers must be refunded the tax they paid – at the time of the purchase**
- 2. Different states have different policies about what’s taxed and what isn’t**
- 3. Multiple sales channels make it difficult to know where to report and remit tax**
- 4. Multiple return options make tax obligations difficult to track**
- 5. Disconnected systems increase likelihood of inaccuracies**
- 6. Regulations are constantly changing in thousands of jurisdictions**
- 7. Tax reporting isn’t uniform across jurisdictions, complicating accounting**
- 8. Governments need to generate revenue – and seek to do so through audits**

As well as what you can do now to prepare for Returnuary with tax and compliance solutions by Vertex.



# Holiday Shopping Season Has Retailers Bracing for Returnuary

Many holiday shoppers start looking for their coveted gifts well before the leaves turn colors and pumpkins are placed on doorsteps. Often on the hunt for deals, they are highly motivated by discounts and special offers during the holiday season. Some even began shopping over the summer, though the majority start before November.

2023 holiday sales will top **\$278 billion**, a **10.3%** to **12.8%** growth year-over-year.

Source: [Deloitte](#)

## When will consumers start their holiday shopping?



Source: [RetailMeNot](#)

Most shopping occurs online because of the convenience, wider product selection, and the ability to read reviews. However, by not seeing the product(s) in person first, shoppers tend to over order what they need and return the items later. “With eCommerce, consumers can’t touch and feel a product until they get it, and then maybe they don’t like it, or it doesn’t fit,” says Peter Olanday, Retail Practice Leader, Vertex. “So, people will buy three of the same item and return the ones they don’t like.”

**“ECommerce generates two-to-three times the number of returns compared to in-store,”** says Michael Simoncic, Managing Director of global business services firm Alvarez & Marsal. And some online purchases — particularly in apparel, auto parts and home goods — have a higher return rate than goods bought in store.



“In 2022, returns cost retailers about **\$816 billion** in lost sales.”

Source: [Fortune](#)



# Inevitable Returns Provide a Growth Opportunity for Retailers

The good news: “Return policies and practices actually drive sales,” Simoncic says. “Without an easy return policy, the customer avoids the purchase, so there’s a certain amount of revenue you leave off the table by not having easy returns.” In fact, big-name brands such as Zappos and L.L. Bean have led the way in leveraging more generous return policies to build loyalty.

Forward-looking retailers use returns to drive growth and position them to generate future sales. According to Mark Mathews, Vice President of Research and Development and Industry Analysis for the National Retail Federation: “Retailers view the return process as an opportunity to further engage with customers, as it provides additional points of contact for retailers to enhance overall consumer experience.”

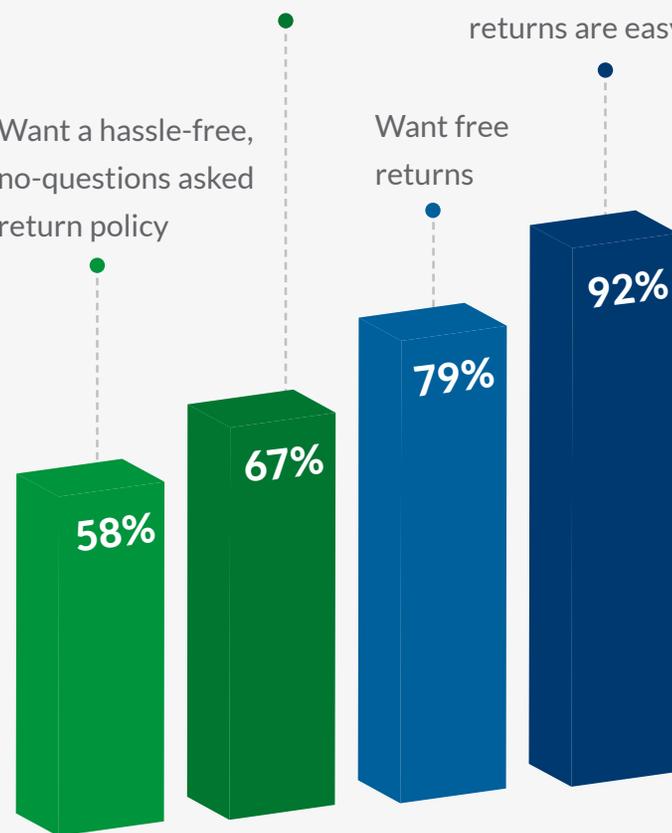
Easy return policies also meet the ever-changing expectations of today’s shoppers:

Check a retailer’s return page before making a purchase

Consumers will buy something again if returns are easy

Want a hassle-free, no-questions asked return policy

Want free returns



Source: [Invesp](#)

## Along with Growth, Returns Bring Retailers Two Big Headaches: Restocking and Tax Reporting

Some items arrive back damaged or, in the case of merchandise like holiday décor, they come back too late to be restocked. As a result, items that can't be resold at full price often end up with resellers. And tax reporting is already time-consuming and error prone. This year's longer eCommerce holiday shopping season only magnifies reporting issues.

“As customers shop earlier, returns become even more complicated, with more time between the purchase and return dates,” Olanday says. “This widens the window where the tax rate at the purchase time can be different from the tax rate at the time of the return, requiring more attention on the historical rate of information.”

Retailers using manual systems may struggle to keep up with the tax compliance requirements retailers face due to the acceleration of eCommerce and omnichannel sales. There are too many variables to keep track of, from changing tax rates to cross-border tax compliance. That's why automated tax determination engines that integrate with business systems must become part of every retailer's toolkit.



# 8 Ways Returns Increase Tax Complexity

The majority of states impose a state-wide sales tax, with a few notable exceptions. In some states, localities also charge a sales tax on top of the state sales tax. What is considered taxable also varies widely, with some states taxing certain types of clothing but not others. All these issues come into play and must be accounted for when a return occurs.

Retailers must consider:

## 1. Shoppers must be refunded the tax they paid – at the time of the purchase

To calculate how much sales tax to refund, retailers must be able to pinpoint the exact tax that was paid at the time of the purchase based on tax nexus, otherwise known as historical tax rates.

What's troubling is that small retailers may not keep a database of historical tax rates for every jurisdiction where they are selling. "If I'm a retailer and I'm only keeping track of tax rates from today going forward, then I have no idea what the tax rate was 90 days ago when that purchase was made," Olanday says.



## 2. Different states have different policies about what's taxed and what isn't

With eCommerce, retailers must stay on top of all tax changes, even in places where they don't have a physical presence, in order to account for any cross-border taxes. This requires them to accurately assign tax nexus to each purchase. Those with multiple locations may sell in more than one state, not just the state where the retailer resides. Not only are there different tax rates to calculate, but different states may tax items differently.

## 3. Multiple sales channels make it difficult to know where to report and remit tax

Buy online, return in-store (BORIS) has become more prevalent in recent years. Without good connectivity between sales channels, retailers may not have accurate visibility on the taxes owed, making it difficult to know where to report and remit sales tax. No matter if an item is purchased in a store, online, or a hybrid of the two, sales taxes must be collected consistently.

## 4. Multiple return options make tax obligations difficult to track

Modern retail is all about choice. Consumers don't pick one retail channel and stick with it throughout their retail journey. They want the flexibility to access the channel that is most convenient when they need it. The same is true with returns. Some shoppers will buy items online, then return them in-store. Others will return eCommerce purchases through mail. But that flexibility makes it difficult to track a retailer's tax obligations, creating inconsistencies. Add in returns on items purchased in marketplaces like Amazon and eBay and through delivery services like DoorDash, and the complexity just keeps growing.

## 5. Disconnected systems increase likelihood of inaccuracies

Further complicating matters is the fact that retailers may use different systems to handle different channels. They might use a point-of-sale (POS) system in-store but a content management system for their website or mobile app. Those systems don't always communicate with one other. As a result, retailers may be reporting tax incorrectly and could be vulnerable to fines in the event of an audit.

## 6. Regulations are constantly changing in thousands of jurisdictions

The Supreme Court's *South Dakota v. Wayfair* ruling means that nearly all online retailers have nexus in almost every state in which they sell. Therefore, eCommerce retailers and marketplaces must stay on top of constantly changing regulations in thousands of jurisdictions.

Even retailers who sell mainly through marketplaces (rather than directly to customers) must still deal with the issue of economic nexus. Some states require that retailers include marketplace sales in calculating their economic nexus, not just direct sales. Other states do not and it's incumbent on retailers to know which ones do.

## 7. Tax reporting isn't uniform across states, complicating accounting

In addition to the complexity of refunding sales tax to consumers, retailers must also be able to claim back the tax they reported and remitted. Again, the process isn't uniform across states. In some, sellers must amend past returns and in others sellers can take a credit. Some retailers find this aspect of accounting too difficult and end up absorbing the refunded tax.



## 8. Governments need to generate revenue – and seek to do so through audits

Further making the sales tax burden more perilous is the fact that state and local budgets are straining under the weight of declining revenues and greater spending.

With sales tax making up as much as 42% of total tax revenues in some states, tax collectors are incentivized to unearth any potential unpaid sales taxes, while also generating revenues with penalties. Retailers should prepare for more audits of their sales tax collections in this environment.

Small and mid-sized retailers can't afford to get bogged down with the stress and potential economic fines of audits. Even with accurate sales tax reporting, companies may still get audited. But correct tax calculations can significantly reduce the errors auditors find. With fewer errors, retailers won't be penalized with fines.

### Common sales tax audit triggers



#### Prior sales and use tax audit

States typically keep track of entities that had significant deficiencies on audits in the past and target them for additional scrutiny.



#### Late filings

Habitually filing sales and use tax returns late gets auditors' attention.



#### Changes in sales tax laws

State sales tax laws change frequently, and errors can result when retailers are based in another state and are unaware of the changes.



#### Being a small business

Small businesses often lack the necessary resources to closely track sales and use tax rates, monitor changes, collect, and remit taxes accurately and on time.

Source: [Accounting Today](#)

# How Retailers Can Thrive in a World with More Returns

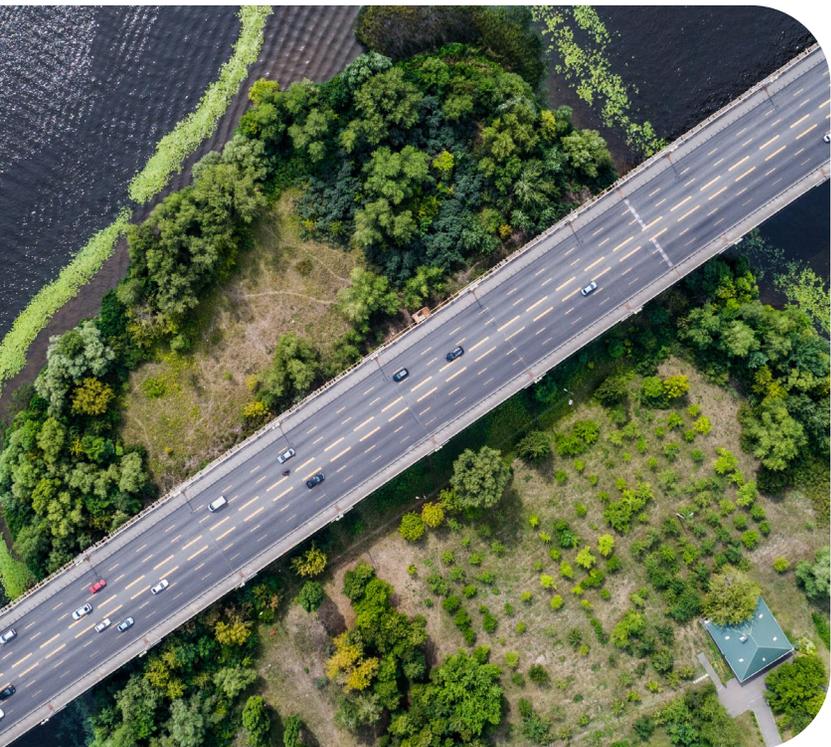
Smart retailers will develop strategies to encourage upselling and cross-selling during the return process. This can help minimize the cost of returns.

Another smart idea: adopting an integrated, modern, unified approach to calculating and tracking taxes that meets consumers where they are. Relying on manual systems is too complicated and results in too many errors, which are both costly and time-consuming.

While many retailers combine ERP, POS, and eCommerce systems to calculate tax, only an integrated and automated indirect tax engine is built to handle both the volume and complexity of retailers' modern-day tax challenges. Using such a solution to accurately calculate taxes can improve tax accuracy, reduce audit penalties, support business growth, reduce delays in vendor payments, and reduce costs.

Companies that are investing in new POS, ERP or procurement systems — or those that are changing their eCommerce platforms — can use that opportunity to introduce tax automation so they can scale their operations and achieve accurate and consistent tax calculation across all of their sales channels.





## Vertex Helps Retailers Spend Less Time on Taxes and More Time on Growing Their Revenue

As tax laws change and evolve, it's important to partner with a provider who will stay on top of the changing tax requirements and build them into solutions seamlessly. Manual sales tax may have been possible in a simpler tax environment, but the rapid pace of eCommerce makes that nearly impossible now. By implementing an integrated and automated indirect tax engine, retail organizations can spend less time on taxes and spend more time on growing their revenue during this holiday season and every holiday season to come.

For more information on Vertex's solutions built for retail, visit [vertexinc.com/solutions/tax-solution-retail](https://vertexinc.com/solutions/tax-solution-retail).

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