



Indirect Tax Policy: 2024 Trends

Factors that indirect tax leaders should recognize,
monitor and act upon

Introduction

A pivotal year with far-reaching indirect tax implications

The biggest election year in global history will have major impacts on long-term indirect tax rules, rates and risks.¹ More immediately, federal, state and local tax policymaking; fiscal conditions; and technological disruptions will muddle the short-term indirect tax environment in the U.S. So, it is important for indirect tax groups, and the external CPAs they collaborate with, to monitor:

- Federal, state and local U.S. indirect tax policy trends
- Nexus updates
- Digital taxes
- Audit and enforcement activity; and
- Tax automation and related technology developments.

Tax Policy Outlook

Federal gridlock and declining state tax revenues may lead to new digital taxes, more fees, and local sales tax rate increases

Sales tax rules and rate fluctuations occur in response to the interplay of federal policymaking, state and local fiscal conditions, fluctuating economic pressures, consumer behaviors (e.g., online and mobile purchasing) and technological shifts. In response, indirect tax leaders and their teams should keep tabs on:

- **A federal tax policymaking standstill:** In a year consumed by Presidential and Congressional elections, it appears unlikely that any substantive tax policy legislation (concerning digital taxation, sales tax reform or anything else for that matter) will occur. Pandemic-era federal funding to state and local governments will soon conclude, and the Fiscal Responsibility Act of 2023 begins cutting large swaths of discretionary spending, to the tune of \$250 billion in the coming decade.
- **State tax revenues are declining:** Following several years of receiving record amounts of federal stimulus funding, states will face harsh revenue and spending realities. Yes, state rainy day fund balances are at post-pandemic highs, but for how long? State revenues from personal income tax, property tax and sales tax have plunged since 2021, and the sales tax base continues to shrink. These revenue declines help explain why more states and local governments continue to implement more fees (e.g., environmental/green fees; retail delivery fees; airport fees; and entertainment district fees among others).
- **Local sales tax rates will continue to rise:** City and county governments are experiencing the difficult one-two punch of inflationary pressure (costs have risen approximately 15-20% in the past several years) with relatively limited revenue-sharing from states. That's why U.S. sales tax rate changes, largely driven by rate changes at sub-state levels, reached a 10-year high in 2023. Among U.S. counties, sales tax rate increases outnumbered decreases by a nearly 2:1 ratio. Among cities, sales tax rate increases outnumbered decreases by almost 5:1.² Expect rates and rules changes to sustain or increase. Additionally, the issuance of debt by government entities has increased greatly in recent years, and preferred methods of funding government include raising rates and expanding the sales tax base.



“We don’t see any kind of substantive tax policy legislation occurring at the federal level in 2024. Regardless of who is elected President and to Congress, there is little appetite for any more federal funding to states. States will have to think hard about paying for a lot of things they didn’t have to pay for since the pandemic struck.”

Vertex VP, Tax Content
& Chief Tax Officer
Michael Bernard

Nexus Updates

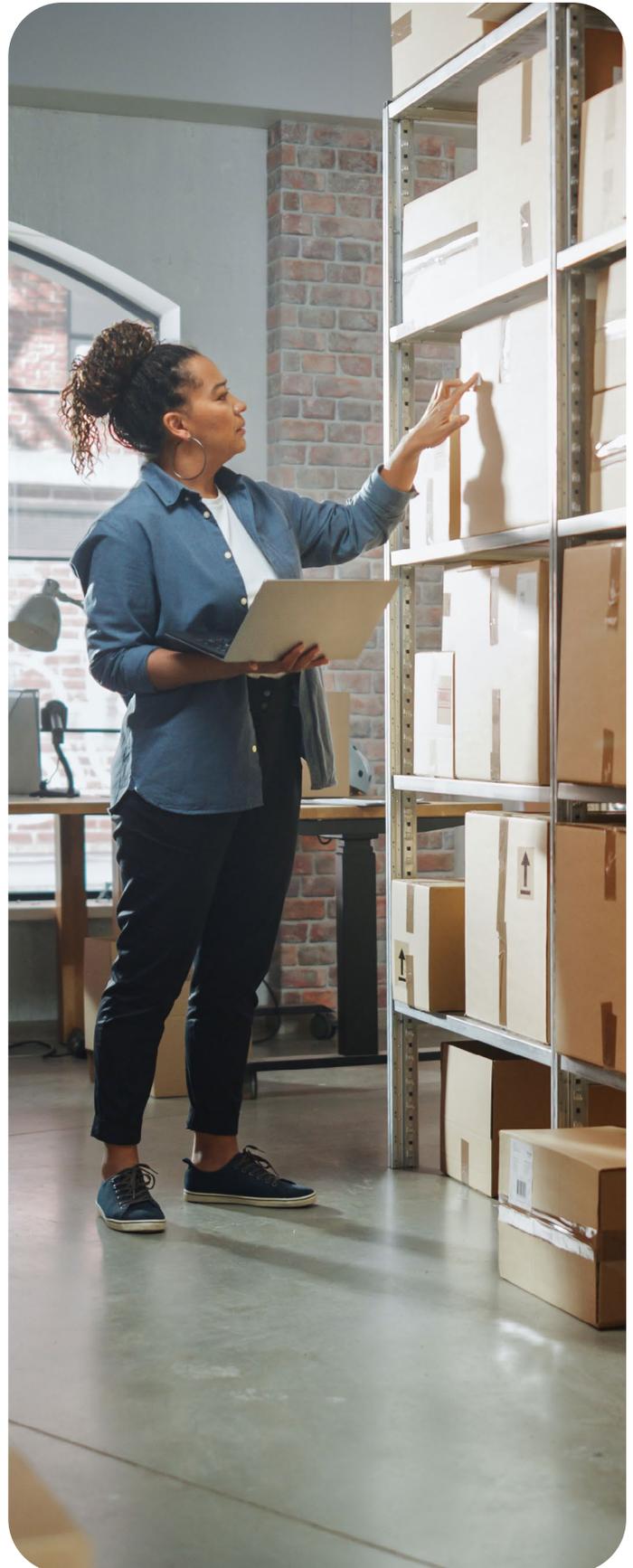
Five years into post-Wayfair nexus rules-making, compliance still lags — and states are getting itchy

Many companies have yet to fully comply with post-Wayfair nexus rules, and states are aggressively pursuing non-filers. Besides identifying state-by-state thresholds and other compliance triggers, indirect tax groups and the CPA firms they collaborate with should recognize that:

- **Economic nexus pervades:** All states with a sales tax have adopted economic nexus. However, these economic thresholds vary significantly from state to state. As such, sellers and CPAs must be diligent in reviewing and applying these rules.
- **Nexus rules change:** States continue to remove transaction thresholds for determining nexus (as South Dakota and Louisiana did in 2023). This means that sales (or gross receipts) volumes determine whether and when a company must register to file sales tax in a state.
- **Definitions of a “sale” vary:** Some states define economic nexus based on retail sales; others consider gross receipts. Resale sales also may qualify as a “retail sale” in certain states.
- **Quill still holds:** The physical presence standard established in the Supreme Court’s 1992 *Quill Corp. v. North Dakota* decision still applies, at a time when in-state remote employees, property and inventory can trigger physical presence.

As a result, tax groups should consider:

- **Keeping current:** Track state-by-state nexus threshold changes while monitoring local tax changes and business activities or assets that might constitute physical nexus.
- **Evaluating all tax types:** Nexus requirements also apply to income taxes, franchise taxes and gross receipts taxes.
- **Confirming the timing of filing requirements:** State rules vary on when companies must register after surpassing a nexus threshold.
- **Spreading the word:** Sales, marketing, real estate, HR groups and other departments should understand nexus rules to prevent tax groups from playing costly games of catch-up.





No Relaxation of Digital Taxation

Digital advertising service taxes remain in limbo; new taxes on digital offerings may fill the void

As states with draft legislation await rulings on the fate of Maryland's digital advertising law (a model for many of those drafts), other forms of digital taxation continue to evolve. Indirect tax teams should monitor:

- The implications of Maryland's law:** Many state legislatures that have proposed new digital taxation rules are monitoring the ongoing legal battle surrounding Maryland's digital advertising tax. State and federal court rulings on the Maryland law could trigger a cascade of new state laws and requirements related to digital taxes. Even as the courts work to finalize their rulings on the Maryland law, other states already are advancing new laws and requirements concerning various types of digital taxes.
- Changing definitions of digital products and services:** Some states have had digital product taxes on the books for nearly two decades. That's an eternity in the digital realm, especially when definitions of digital products have not been updated.
- The upcoming Multi-State Tax Commission (MTC) report:** The MTC's Sales Tax on Digital Goods & Services Uniformity Project workgroup is expected to create broad definitions for digital taxes, which states could use to exempt certain types of taxes (e.g., digital advertising taxes), or taxable categories (e.g., business inputs). A report due by the end of 2024 could influence 2025 legislative activities. The Streamlined Sales Tax group is also evaluating digital goods and services sourcing.
- More digital taxes:** Approximately 25 states impose digital taxes on products or services; 6 other states do so via guidance or case law. Those numbers could climb as the U.S. sales tax base continues to shrink, and as state fiscal conditions decline from post-pandemic booms.

Audit and Enforcement Trends

Audits are increasing; be prepared

After a pandemic-driven lull, sales and use tax audits continue to increase as more state auditors deploy sophisticated analytics to sharpen targeting and investigations. Auditors, who continue to conduct high numbers of virtual audits, are also shifting to increasingly focus on internal controls and tax policy with verification rather than tracking down errors in individual transactions. In response, tax groups should:

- **Recognize remote-worker risks:** Remote employees with new payroll registrations are triggering inquiries regarding sales and use tax nexus.
- **Upgrade system documentation:** Effective system documentation enables auditors to perform a broad review of internal controls and processes as opposed to extensive transaction audits. Auditors appear more open to relying on system configurations after conducting reduced transaction testing.
- **Review classifications:** Auditors are uncovering more issues with classifications of products and services. (e.g., whether an offering qualifies as software as a service, an information service, or a professional service).
- **Exemption Certificate Management:** Auditors will always focus on exempt sales. This means that companies must have current exemption certificates from purchasers. Centrally managing exemption certificates is the most effective approach.
- **Prepare for consumer use audits:** Purchasers and consumers use tax remains an auditing focal point. Scrutinize treatments of direct purchases, goods movements, inventory withdrawals and intercompany transactions.
- **Conduct overpayment reviews:** States rarely point out overpayments so tax groups should conduct periodic reviews on their own. Tax leaders also should consider the voluntary disclosure agreements (VDA) that most states offer as well as amnesty programs.

“States are becoming more analytical when it comes to picking and choosing which companies they audit. They’re looking at prior audits to assess what may be more fruitful targets. They’re taking close looks at industries and revenue. States are even zeroing in on specific departments within a company.”

Wipfli LLP
Director, SALT
Keela Ross



Tax Automation and Transformation Opportunities

10 ways to evaluate the efficacy of your current tax technology

As indirect tax changes increase, tax automation marks an increasingly valuable weapon in the battle against compliance complexity. Tax technology continues to evolve by integrating generative artificial intelligence (AI), machine learning, robotic process automation (RPA), and edge computing. Working through the following questions will give tax groups and their external advisors a better understanding of opportunities for automation improvements:

Level 1: Starting Out

1. What do you need? Focus on short-term (2-year) and longer-term (5-year) goals and how do those align?
2. What are your growth plans?

Level 2: Advanced

3. What are your challenges?
4. Who will lead this project and who are key stakeholders?

Level 3: Tech Stack Conversations

5. Does your company add 500 new products per month? (If so, AI functionality may help mapping.)
6. Identify code-matching/risk-matching needs.
7. What technology is currently in use?
8. Identify potential vendors and their pricing models.
9. What is your tax technology budget, and how does that align with the organization's technology roadmap?
10. Do you have an RPA requirement?

“Doing tech for tech’s sake doesn’t help anybody. However, if you know what you need and then go get the right technology, you can really elevate your organization.”

CPA.com, Product Marketing Manager,
Christina Wiseman





Conclusion

Be proactive

As indirect tax groups and their external advisors adjust to a big year – not only for worldwide elections, but also for geopolitical, economic, and social volatility – they should respond proactively to:

- Aggressive nexus enforcement and auditing activity at the state level
- Rising sales tax compliance complexity, especially for technology-related transactions
- New digital taxes; and
- Even more sales tax rate increases at the local level.

End Notes

¹2024 is the biggest election year in history, The Economist, Nov, 13, 2024: <https://www.economist.com/interactive/the-world-ahead/2023/11/13/2024-is-the-biggest-election-year-in-history>.

²A record year for U.S. sales tax rate changes, Michael Bernard, Jan., 11, 2024: <https://www.vertexinc.com/resources/resource-library/record-year-us-sales-tax-rate-changes>.

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