



Five Factors of Freight Taxability

» Introduction

Whether consumers are buying gifts for family or companies are purchasing steel for a factory, e-Commerce has made remote purchasing and shipping commonplace. But the ease of buying goods and having them delivered creates tax complexities for the sellers, in the form of freight and shipping charges.

Freight taxability goes by many names — such as shipping, transportation or delivery charges — and has generated attention because of the confusion it can sometimes cause. Freight and shipping charges are, by definition, charges by the seller for the preparation and delivery of tangible personal property to a location designated by the customer. The rules for the taxability of freight or delivery charges vary from state to state. But how do retailers figure out when freight and shipping charges related to retail sales are subject to sales and use tax? This e-Book offers the answers.

Ask and answer these five questions in order to better manage freight tax costs:

1. Is the freight taxable in the state of origin?
2. Are the goods taxable?
3. Is the freight separately stated?
4. Who is providing transportation for the shipment?
5. What are the seller's shipping terms?

While these factors are straightforward individually, misinterpretation of their application can cause problems for businesses:



1 Is The Freight Taxable In The State Of Origin?

Every state has its own statutes and regulations regarding the taxability of freight and shipping charges. In most states, freight and shipping charges are considered part of the gross receipts or sales price and are therefore subject to tax. Other states never charge sales tax on freight or shipping charges.

2 Are The Goods Taxable?

Imagine that a grocery store wants to buy three tons of produce from a supplier. Would the freight charges to deliver this produce be taxable? It depends on the particular state's rule regarding the taxability of certain types of produce. Some states do not tax specific categories of products, such as food. In addition to the category of the product, the intended use of the product affects whether it is taxed. In some states, a pumpkin is taxable if you intend to use it for decorative purposes, but not if you plan to consume it. Therefore, if the produce is considered a taxable good, the freight, shipping or delivery charges are taxable.



State-By-State Tax Complexities



Three examples of differences in state tax rules illuminate the challenges today's retailers face:

Connecticut: Shipping and freight charges are generally taxable in Connecticut if they're related to the sale of taxable goods. However, if the shipping is for exempt goods (like groceries), the charges might be exempt as well.

Maryland: Freight and shipping charges are not taxable, but handling charges are. However, if the charges are bundled as "shipping and handling," the entire amount is taxable

Illinois: Freight and shipping charges are taxable only if the charges are separately stated on the invoice. A lump-sum delivery charge would be exempt only if the price of the exempt items is greater than the price of the taxable items.

3 Is The Freight Separately Stated?

Showing freight charges separately from other charges on an invoice can sometimes result in freight being tax exempt in certain states. However, some states will still tax freight even if separately stated. It is important to determine this distinction in the state where one is doing business, because sellers sometimes combine the freight and handling charges (e.g., "S&H.") Since most states charge tax on handling, combining freight and handling renders both taxable, while listing them separately makes one non-taxable in certain states.

Showing freight charges separately from other charges on an invoice can sometimes result in freight being tax exempt – but only in certain states.

4 Who Is Providing Transportation For The Shipment?

The fourth factor that affects the taxability of freight is who provides the delivery. Whether shipping is a necessary part of the sales transaction can affect whether it is taxable. When a seller sends freight by common carrier or the postal service it is less clear whether doing so is a necessary part of the sales transaction. If the grocery store were to use its own trucks to transport the produce, doing so would indicate that shipping is a necessary part of the sales transactions and make the freight taxable in many states.





5 What Are The Seller's Shipping Terms?

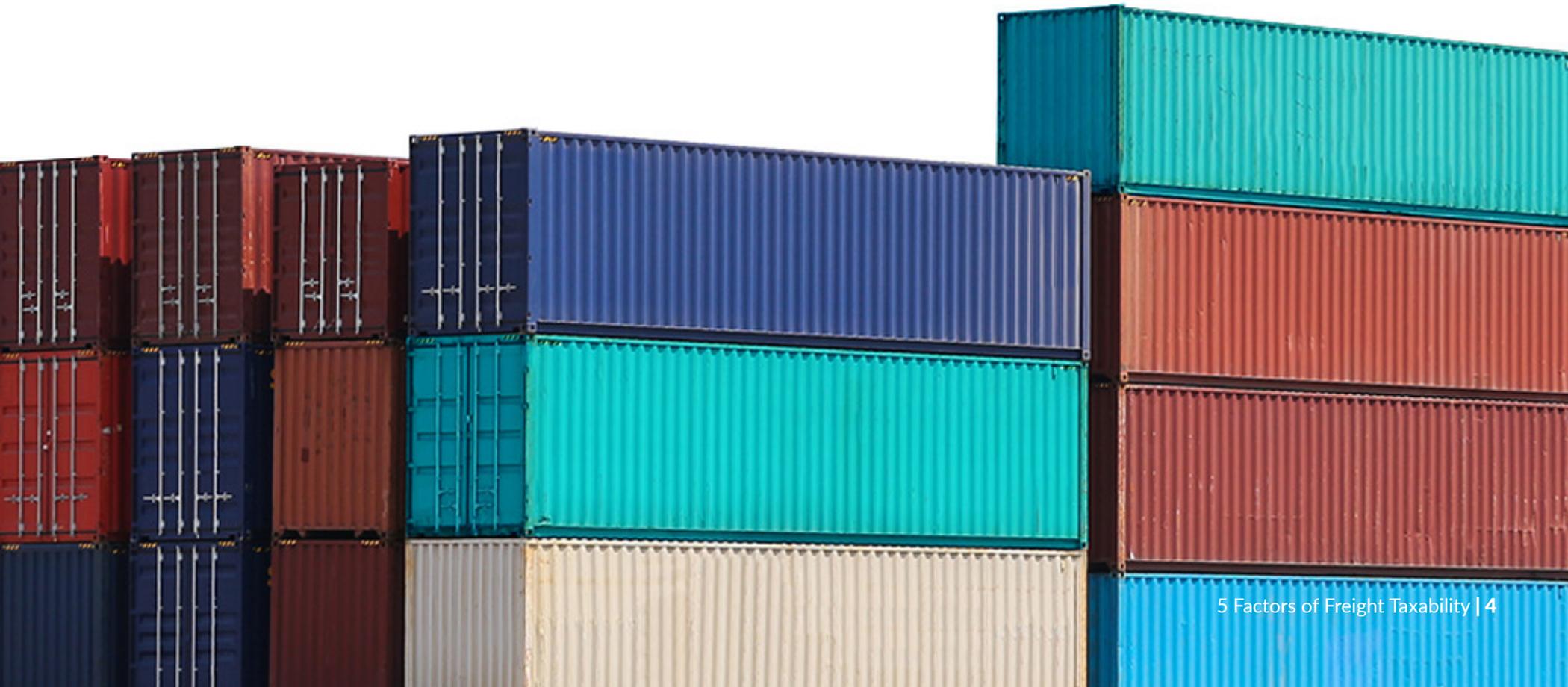
Lastly, the shipping terms of the seller have implications for the taxability of the freight and who pays for the tax. Also, did the seller charge more for freight? Shipping terms refer to the legal stipulation in the purchase agreement of the good. When the grocery store purchased the produce, it entered into a legal agreement in which the shipping terms for the grocery store were stipulated.

There are two main shipping term distinctions that typically impact the taxability of freight:

- The first is **Free On Board (FOB) origin**. In this example, the title and legal ownership of the freight were transferred as soon as those three tons of produce were purchased. In the case of FOB origin shipping terms, freight is typically exempt from tax in many states. Sellers tend to have FOB origin shipping terms because those terms defer liability to the buyer.
- The other shipping term, **FOB destination**, entails that title is not transferred until the buyer receives the goods. Freight is usually taxable in the case of FOB destination.

» Conclusion

The taxability of freight and shipping charges is a highly complex issue, and state tax laws vary greatly. On this journey from purchase to store, many factors influence whether freight is taxable. For each factor, there often are exceptions based on the tax rules of particular states. Consult your state tax code or trusted tax advisor for specific answers.





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