Automated Compliance for New State Tax Mandates

What's Way Fair for Manufacturers and Distributors?

Automating the Collection of State Sales Tax and Exemption Documents

Whitepaper sponsored by

Avalara

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What's Way Fair for Manufacturers and Distributors?

Automating the Collection of State Sales Tax and Exemption Documents

New mandates to collect state sales taxes and manage tax exemption documents affect manufacturers and distributors. What you need to know.

The Internet transformed how all businesses, not least of all manufacturing and distribution, conduct transactions with their customers and partners. The United States Supreme Court decision in *South Dakota v. Wayfair, Inc.* also recognized how the Internet has changed standards for collecting state sales taxes and managing state tax exemption standards. While the ruling originated to address the tremendous growth of ecommerce since 1992, it also affects manufacturers and distributors with minimal or even no ecommerce operations.

Industry Today spoke to the tax experts at Avalara, a leading provider of automated tax compliance software solutions, to understand the ramifications of *South Dakota v. Wayfair, Inc.* for manufacturers and distributors and how best to address them.

What is *South Dakota v. Wayfair, Inc.*?

In 1992, three years before Amazon opened an online bookstore and 15 years before the first iPhone, the United States Supreme Court ruled in *Quill Corp. v. North Dakota* that a state could not require an out-of-state seller with no physical presence in the state to collect and remit sales tax. It goes without saying that ecommerce is a much bigger factor today than it was then.

Which is one reason in 2018 the Supreme Court ruled in favor of South Dakota. In overturning Quill, the decision eliminated the physical requirement and held that states could require out-of-state sellers to collect sales taxes as long as the collection did not represent an unreasonable burden on retailers or discriminate against interstate commerce.

Specifically, tax collection is not considered unreasonable if:

- It is not retroactive.
- Only merchants with a considerable amount of business in the state are required to collect (South Dakota defines it as $100,000 in-state sales or over 200 orders in the state, a "nexus" that has become a model for other states).
- Standard rules are adopted to minimize administrative and compliance costs on the business to collect taxes.

Needless to say, other states saw a revenue opportunity and were quick to adopt laws similar to South Dakota's law in order to require out-of-state sellers to collect sales taxes (or, to provide documentation as to why sales are tax-exempt). As of February 2020, 43 states as well as the District of Columbia have some sort of tax collection requirements for remote businesses. The requirements are similar, but not always the same, making compliance across different jurisdictions particularly cumbersome. And they're still being refined and adjusted.

How does this affect manufacturers and distributors?

While the Wayfair decision was in direct response to the physical presence "loophole" that allowed online retailers to dispense with state sales tax collection, it also applies to any out-of-state business that sells products to customers in the state. It doesn't matter whether the transaction is conducted online or not.

As Maria Tringali, manufacturing sector expert at Avalara, points out:
"Because ecommerce platforms make it easy to eliminate the middlemen, manufacturers and distributors are increasingly moving towards direct-to-consumer models. Which means they need to collect sales taxes for every state they do business in where they exceed the nexus requirements, regardless of whether they have a physical presence."

The problem for many smaller manufacturers and distributors is that in most states the revenue threshold for requiring compliance is not that hard to meet. Avalara's Scott Peterson, Vice President of U.S. Tax Policy & Government Relations (and South Dakota's former sales tax director), explains:

"The language of the South Dakota legislation that just about every state has copied defines the economic threshold, or nexus, to collect taxes as based on 'gross income' from sales. That's a much broader definition than was typically used as a standard to require state tax collection. The result is that more smaller businesses that never had to worry about sales tax because they didn't sell enough are now under scrutiny.

B2B manufacturers and distributors are also affected.

For manufacturers and distributors that are exempt from sales taxes because they don't sell to end-users, why should this matter?

Because states still require the collection and maintenance of tax exemption (also known as resale exemption) certificates for each affected customer. Prior to *South Dakota v. Wayfair, Inc.*, there generally was no need to file for exemptions unless the business had a physical connection in the state. Now, any business with economic nexus in a state must file the appropriate tax exemption certificates.

In some respects, this is an even more involved process than collecting taxes, particularly given varying requirements within and across states. It imposes a considerable recordkeeping burden, even for companies that don't collect sales tax. In the event of an audit, failure to present proper records of tax-exemption certificates can result in significant legal exposure.

How States Add to the Complexity

While many states copied the South Dakota model, their remote sales tax laws are not all the same. So businesses now not only have the extra headache of sales tax collection and exemption documentation, but multiple headaches in dealing with varying rules among the different states they sell in. Not to mention knowing what the rules are in the first place.

Silvia Aguirre, Avalara General Manager of Certificate Management, explains:

"If you sell a widget to a major retailer, and you meet the nexus requirements for the states that retailer sells in, you need a tax exemption certificate for each of that retailer's locations in each state. And each state may have different documentation requirements and expiration dates. Now, say you are selling the same widget to other retailers in other states. You need tax exemption certificates for each retailer and the states they operate in. So just one product creates a lot of record keeping. Which is of course repeated for every different widget you sell."

Consequently, small-and medium-sized businesses are now confronted with a potentially overwhelming recordkeeping obligation. These companies might employ an accounting firm or a sole-proprietor CPA to help them comply with varying new laws whose nexus and enforcement requirements may be unclear.

Even large companies with their own accounting and Enterprise Resource Planning (ERP) systems are uncertain how to proceed. Bill Troiano, manufacturing sector compliance expert at Avalara notes:

"Our large manufacturing customers are coming to us saying, 'We never had to worry about any of this stuff before Wayfair. What do we need to know and how do we do it?' There's a real liability that if you don't collect sales tax properly and don't maintain proper tax exemption documentation that pertains to each state where you meet the nexus requirements, it could result in a significant financial impact in the event you are audited."

So, what can manufacturers and distributors do to protect themselves?

Start by Learning the Rules

While large businesses may already employ the professional resources to take a closer look at the issues raised by *South Dakota v. Wayfair, Inc.*—or turn to outside experts for advice—small- and medium-sized manufacturers and distributors typically find themselves uncertain about next best steps. Peterson notes:

"Typically, the company's CPA or accounting firm finds itself overwhelmed with monthly recordkeeping of taxes collected and tax exemptions that need to be filed. On top of that, legislative regulations and tax rules are constantly changing, so there's the added burden of trying to stay up-to-date with multiple tax jurisdictions not only at the state level, but county and local levels."

Indeed, Avalara operates an online "university" that provides expert instruction on a range of tax matters. Building on what there is to learn, the next step is to implement a tax solution based on the latest laws and rules where manufacturers and distributors need to comply to streamline returns filing and exemption certificate recordkeeping.

Tringali adds:

"Small- and medium-sized manufacturers and distributors are searching for information about how to comply with new regulations and are looking for the best possible solution that both minimizes risk as well as manual processing. Part of our mission here at Avalara is to explain why they are now required to collect taxes and maintain tax exemption records, as well as when and where it applies to their particular business operations."

Automate Compliance

Just as technology makes B2C easier than ever, technology makes it relatively easy for manufacturers and distributors to be in compliance. An automated tax solution provides a range of capabilities to:

- Track sales where there is an obligation to collect sales tax and appropriate tax exemption certificates.
- Calculate rates and rules based on geolocation and product classification.
- Prepare and file returns.
- Distribute payments to appropriate tax jurisdictions.
- Omit tax from exempt sales.
- Manage exemption documentation.
- Provide on-demand access to reports and all relevant data.

In addition, the tax solution should:

- Integrate seamlessly into the company's existing accounting system.
- Be user-friendly, without requiring additional effort from IT and finance teams.
- Scale as the business grows, both domestically and globally.
- Ensure that in the event of an audit, all recordkeeping and documentation is not only up to date, but easily and readily accessible.
- Collect and manage forms from independent contractors.
- Manage other tax situations such as:
  - Use tax
  - Value-Added Tax (VAT)
  - Customs Duty and Import Tax
  - Lodging Tax
  - Excise Tax
  - Communications Tax
  - Goods and Services Tax (GST)
- Offer a free trial period to ensure the tax solution satisfies the needs of the business and its tax obligations.

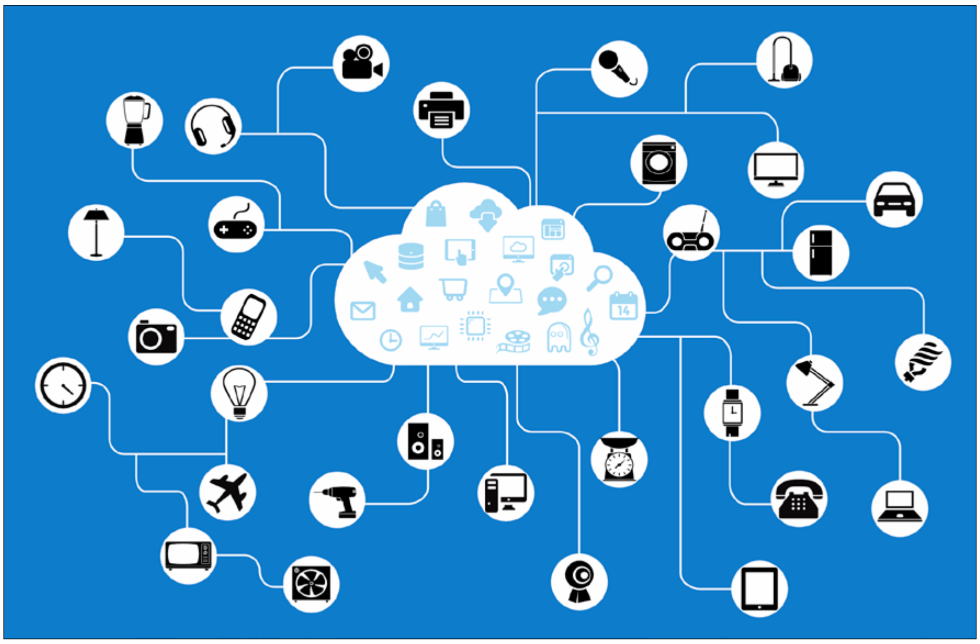
Key to an effective solution is on-demand availability of service without an extensive IT infrastructure.

Look to the Cloud

Troiano emphasizes the importance of a cloud-based solution:

"A cloud-based technology is a powerful and flexible tool to manage the evolving uncertainties of compliance. A lot of manufacturers and distributors still maintain on-premise systems. A cloud-based solution can work with those systems without requiring any additional hardware or reprogramming. Manufacturers and distributors have all different kinds of systems, from QuickBooks to full-fledged ERP systems like SAP. Avalara has over 700 integration partners. Which not only means a cloud-based solution can talk directly to your existing systems today, but can be easily configured with any systems you choose to use tomorrow, and can grow as your business grows."

One solution does fit all sizes. Whether a manufacturer or distributor is large or small, a cloud-based solution can apply the most current tax rates and rules automatically, without any manual intervention.

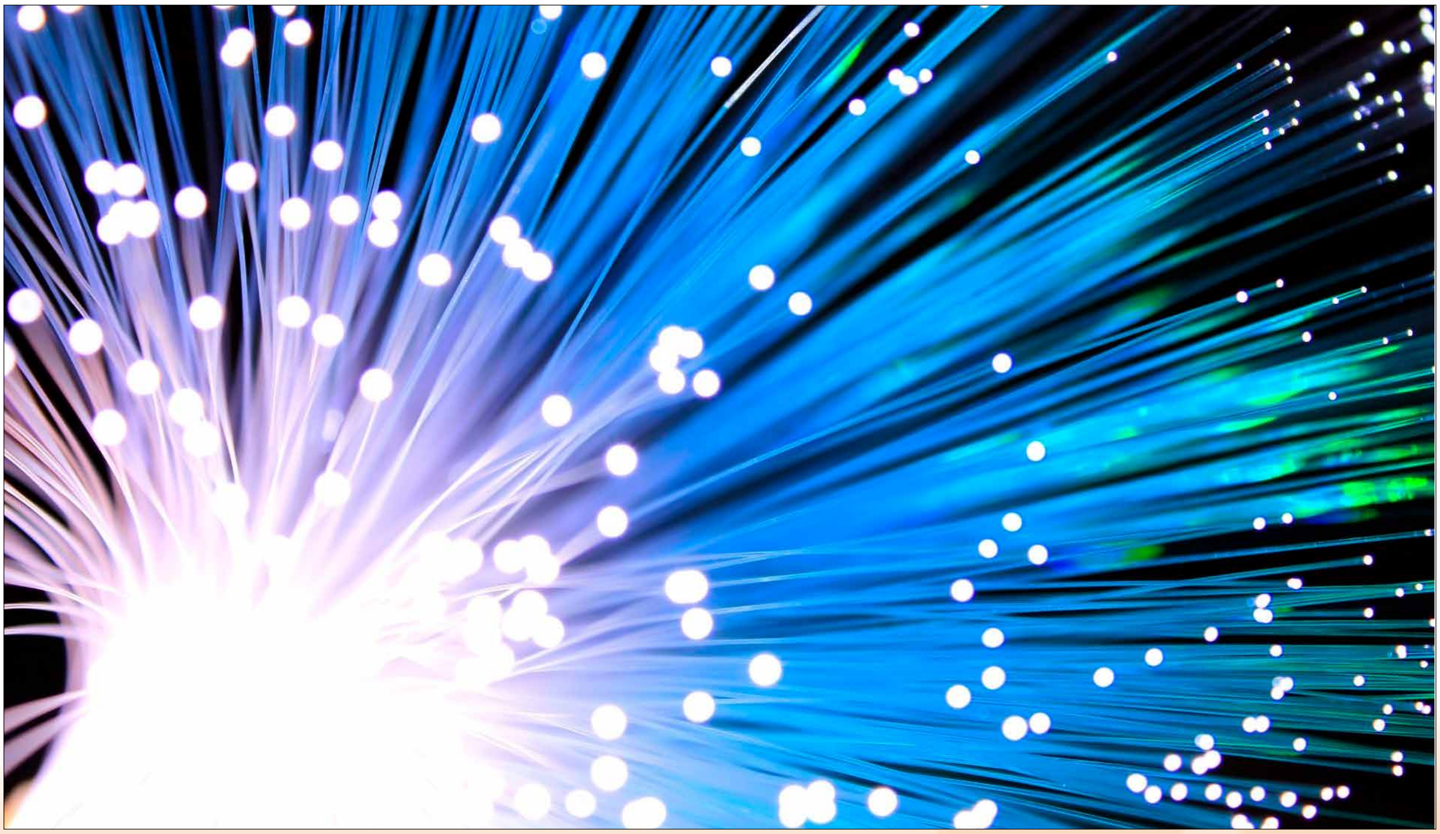


Peace-of-Mind Protection

It's been about 18 months since *South Dakota v. Wayfair, Inc*. changed the rules of engagement for manufacturers and distributors. There's still some unsettled territory. For example, it's not clear how drop shipping may affect tax obligations in certain states. And states are continuously changing their tax laws. Utah, for example, enacted an income and sales tax reform bill in December only to repeal it in January in response to a citizen-initiated petition.

It has also been reported that some manufacturers and distributors are holding off on collecting taxes and tax exemption certificates in states that haven't yet clearly defined their economic nexus laws. Some smaller businesses may feel the cost of compliance outweighs any fines that might be imposed if they are audited, and some are even betting that states will find the cost of auditing and prosecuting outweighs any potential penalties.

These might not be the best bets, however. The fact is that states are implementing laws in light of *South Dakota v. Wayfair, Inc.* The fact is, in response to South Dakota v. Wayfair, Inc., states are implementing laws that may affect manufacturers and distributors that don't physically operate in the state. A tax collection and certificate exemption solution can protect against the potential of fines, in addition to the expenses incurred in complying with an audit.



Tringali points out how an audit can burden a company's resources and its bottom-line.

"The manual collection of tax documentation for an audit can literally take several days for each request. That places a strain on resources that have to spend time in searching for documents instead of doing their jobs, not to mention the added expense. With an automated tax solution, you have instant access to all the documents you need."

Aguirre adds further advantages to an automated solution.

"The system is designed to ensure you are as compliant as possible. The tax rates are accurately collected for each state, even as states constantly change the rates. You avoid the possibility of expired tax exemption certificates. All your tax forms for every state are updated and current. You can run reports and research information that is immediately available at your fingertips and is integrated directly into your existing systems."

Which is why over 25,000 companies worldwide enjoy peace of mind by employing tax compliance software. For further information, visit Avalara to learn about how manufacturers and distributors can automate the major steps of state sales tax compliance. Schedule a demo to see how it can work for your enterprise.

Avalara