5 Reasons Why High-Growth Companies Stumble with Sales Tax

Avalara
Companies grow in vastly different ways. Some do it loudly, with splashy headlines and aggressive market trading. Others do it quietly, behind boardroom doors or on factory floors. But whether its stock rooms or stock prices driving growth, if your business is changing, your tax liability is likely changing too.

Nearly every industry has to deal with sales tax in some way, but high-growth companies have it the hardest – and for good reason. Growth equals change. And with change comes new or different rules and regulations to follow – many of which may be unfamiliar territory to you and even to the taxing authorities that enforce them.

Before the ecommerce boom, sales tax didn’t make the headlines or get a lot of attention from company executives. But the ever-increasing popularity of Cloud and mobile has shifted the tax landscape dramatically, incenting lawmakers to reinterpret the rules and forcing companies to comply.

All roads lead to nexus

It’s impossible to tackle sales tax compliance without first understanding nexus – a company’s economic “connection” to a state based on qualifying sales activities.

More than 20 years ago, the Supreme Court’s landmark decision in Quill v. North Dakota determined that companies without close ties to a state didn’t have to collect tax from customers in that state. However, the growth of ecommerce created a situation states couldn’t afford: loss of tax revenue from buyers purchasing from sellers who had no obligation to collect and remit sales tax. In theory, those buyers should pay use tax on the transactions, but in practice, almost none of them do. At last count, states are missing out on more than $24 billion in uncollected tax on remote sales.

Those losses, combined with outdated and inadequate federal legislation has led states to take another tack: expanding the definition of nexus to include a much wider range of activities – many of which are the very tactics employed by companies to grow their business. Some states are even introducing economic nexus, basing the obligation to collect sales tax in a state solely on volume or total dollar value of sales into that state.

Below are five activities that high growth companies undertake that can be a roadblock to sales tax compliance:

1. Domestic and global expansion. Physical expansion is still a key factor in business growth for many companies. But operating in more locations can also create new tax obligations, often faster than high-growth companies can adapt. Adding staff who work remotely (or
Sales tax on services_What small businesses need to know

at a home office) in a new state can add obligations to register, file, and remit taxes in that state and all its local jurisdictions. Opening new warehouses or distribution centers – including drop shipping warehouses – can similarly create new nexus connections. Having nexus in one or two states might be manageable, but once you have nexus in 5+ states, sales tax gets exponentially more complicated as rates, rules, and filing requirements can vary greatly from state to state.

Global expansion has its own unique tax challenges. Conducting business overseas is vastly different from the United States. Many foreign markets operate under the value-added-tax (VAT) system, which does not follow the same assessment, collection and payment structure as US sales tax. International transactions also typically involve customs, duties, tariffs, and landed cost, each of which has its own set of rules and complexities. The process can be overwhelming (and risky), which is why many companies resort to hiring intermediaries or export agents to help them comply, which can add greatly to business expansion costs. To learn more, watch a short 3-minute video on VAT.

2. Marketing or selling online or through affiliates. Reaching new audiences is a key strategy for any growing business. And the Internet is a great revenue source; for you – and for the states. Half of US states now require remote sellers to collect sales tax on ecommerce transactions. And 17 have affiliate or “Amazon” laws related to ecommerce selling.

For example, if an in-state online business leads a customer via links (“clicking through”) to buy something from the out-of-state online business, the out-of-state business is considered to have a presence in that state and must collect sales taxes from customers there.

These nexus triggers, sometimes referred to as “Amazon laws,” can affect companies of all sizes, but high growth and ecommerce companies are primary targets because they are primary users of online marketplaces, digital advertising and Internet referral programs.

If you use click-through marketing or affiliate programs to drive sales, be sure you understand how it impacts your nexus and tax compliance.

3. Adding products or services. Growth-driven companies are always innovating, looking for ways to break into new markets or reach more customers. However, adding new products
or services to your offerings can make compliance tricky, especially in emerging industries like software and digital goods and services where tax laws haven’t caught up with technology. But just because the states aren’t early adopters doesn’t mean you get a pass on compliance.

Product and service taxability can be difficult to determine. And there is little consistency from state to state. Some products or services are taxable in some states, but exempt in others. Other products and services are “sometimes taxable,” adding another layer of confusion. For instance, in Colorado, straws and cup lids for takeout food are considered taxable, but the cups themselves are exempt. In Texas, customers buying five or fewer donuts have to pay sales tax – maybe it’s better to get the half dozen, since buying six or more means the purchase is exempt.

Software companies, in particular, are some of the hardest hit by the complexity of taxability. Software is now taxed 450 different ways based on 45 different categories, nuanced down to such criteria as physical or digital, custom or canned, software as a service (SaaS), or some combination thereof.

Let’s say a software company launches a new product and allows customers to buy it both as a physical disc and digital download. Let’s also say that support and installation fees are included or available with purchase along with licenses. Depending on the exact nature of the software, any services provided, and the distribution method, this single transaction could be taxed at very different rates depending on where it was purchased, who purchased it, and whether it’s taxable or exempt or partially exempt based on state or even local jurisdiction rules.

More states are also taxing services. Eighteen states now apply sales tax to at least some services. The sourcing rules for determining obligations can be tricky, especially if you have contractors or outsource these services to third parties.

It’s easy for high-growth companies to get tripped up by product and services taxability, especially when their focus is on how to add value to the business, not tax liability. To make matters worse, every year, thousands of rate changes, product taxability rule changes, and Department of Revenue rulings are made that affect sales tax on products and services. Already in 2016, more than 24,400 product taxability changes have gone into effect in the US alone.
4. Filing in multiple states. To stay on the good side of auditors, you’ll need to register for sales tax in every jurisdiction where you have nexus. Then, you’ll have to contend with a morass of filing deadlines and requirements that are different in each state. The frequency with which you’re required to file, as well as whether you’re required to pre-pay part or all of your expected sales tax obligations, can change as total sales made to customers in a state grow. Each state you file in makes your compliance picture exponentially more complex, requiring adoption of new sales tax rules and regulations that can get confusing fast.

Tracking due dates and filing schedules, managing notices from each state Department of Revenue, filing local returns, managing different payment methods and forms can become a huge burden. What was once a small annoyance can quickly grow beyond what’s reasonable to manage in-house, eating up valuable staff time and becoming a drain on resources and morale.

5. Gaining a high public profile. Congratulations, your company’s making headlines! The journey from start-up to industry giant often happens quickly, but rarely quietly. Idea-to-IPO success stories stud the news daily and investors, analysts, and consumers are swift to home in on the hottest companies to hit the market. This high visibility is great for growth, but it can be a magnet for states – and state auditors – looking to draw in more tax revenue from profitable ventures. Companies with a higher profile and higher revenues tend to be chosen for audits more often. And if you have multi-state nexus, you could be looking at multiple audits.

**Bottom line: automate to avoid risk**

High-growth companies can’t afford for sales tax to slow them down. State sales tax authorities traditionally watch companies closely in industries where compliance has historically been lax. One costly sales and use tax audit could spell major problems, especially if you are anticipating a liquidity event.

Compliance problems multiply during high growth periods. When manual compliance starts to create problems, it’s time to automate. Dozens of business processes are now handled through software and SaaS solutions. Sales tax is no exception. Tax automation software integrated into your existing ERP, ecommerce or billing system is an easy, affordable and reliable way to stay on top of tax compliance as you grow.
Go with the best

Avalara’s end-to-end sales tax compliance solution scales with your company at every phase of growth, from the home office to the Fortune 500. Avalara’s industry-leading tax calculation engine is lightning-fast, returning sales tax calculations in an average of just 0.0651 seconds. Every jurisdiction, every rate, every regulation: Avalara’s expertise in sales tax is so deep that we offer the industry’s first-ever Accuracy Guarantee.

With Avalara, filing and remitting taxes no longer has to be a time-consuming chore involving remitting separate checks for each jurisdiction and filling out a range of different forms. Instead, automated filing means you review a brief report, then click to pay. Avalara uses just one direct deposit from your company, automatically dividing up the total and remitting the correct amount to each jurisdiction.

Pre-built integrations mean that you can get better tax compliance while still using the ERP or accounting software you’re already familiar with – and our wide range of integrations (along with an API for companies with a homegrown solution) means that even when you change software, you can keep the fast, accurate calculation you’ve grown to trust from Avalara.

Don’t wait until you’ve outgrown your current get compliant with sales and use tax regulations. Do it right the first time, with a solution that scales with you – wherever you grow. Visit www.avalara.com today for more information on how Avalara can make compliance easier for your high-growth business.

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<td>Even though they add just a small percentage to purchase prices, the combination of general sales taxes (applied to most transactions) and selective taxes (levied on transactions like hotel room rentals or alcohol purchases) account for a whopping 47 percent of state revenue, according to the U.S. Census Bureau. To put that total in perspective, state income tax only accounts for 35 percent of state revenue.</td>
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<td>It’s easy to see why states have started looking more and more toward sales tax auditors to help with revenue shortfalls. Politicians would rather enforce existing tax collection laws than face scrutiny for raising taxes, so this is a trend that is likely to continue.</td>
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About Avalara
A privately held company, Avalara was founded by a team of tax and software industry veterans to fulfill a vision of delivering an affordable, scalable sales tax solution. Thus making what was not economically feasible in the past for mid-sized business not only affordable, but more accurate as well – all with the latest and most innovative technology available. From Bainbridge Island, close to Seattle, Avalara’s knowledgeable staff works tirelessly to help customers put the hassles of sales tax compliance out of mind. Avalara’s mission is to transform the tax process for customers by creating cost-effective state-of-the-art solutions. The company does so through integrated on-demand, Web-based software services that provide transparent transactions, accurate tax compliance, painless administration and effortless reporting.