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US sales and use tax in a nutshell

Global Indirect Tax Advisor webcast series

—

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Agenda

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2 **Top compliance and audit issues**

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4 **Q&A**

Administration

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— If you qualify for the certificate of attendance, it will be sent to you following the webcast.

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Overview of US sales and use tax

Sales tax definition

- Sales tax is imposed at the state and local level in the US — there is no federal sales tax.
- Sales tax is a consumption tax imposed on retail sales to end consumers. Sales made along the supply chain (i.e. resales) to parties other than the end consumer (e.g., resales) are generally not taxable.
- Sales tax is generally imposed on all sales of tangible personal property, but usually only certain enumerated services depending on the state. The sale of intangibles and real property are generally not taxable.
- The economic burden of the sales tax is generally borne by the consumer, but the tax is collected and remitted by the seller to the state.
- Sellers may be required to remit tax to the state on a monthly, quarterly, or annual basis. If a seller does not collect tax, the purchaser owes USE tax which is complementary to the sales tax.

VAT/GST vs. sales tax

	VAT/GST	Sales tax
Taxpayer?	Sellers (or buyers) of taxable goods and services	Sellers (or buyers) of taxable goods and services
What?	All goods and services	All tangible personal property and enumerated services
Where?	Where goods/services are consumed	Where goods/services are received/enjoyed
When?	At each stage of consumption chain	Sales to end consumer
Tax base?	Sales price	Sales price
Tax burden?	End consumer	End consumer and businesses when transaction is non-exempt

Use tax definition

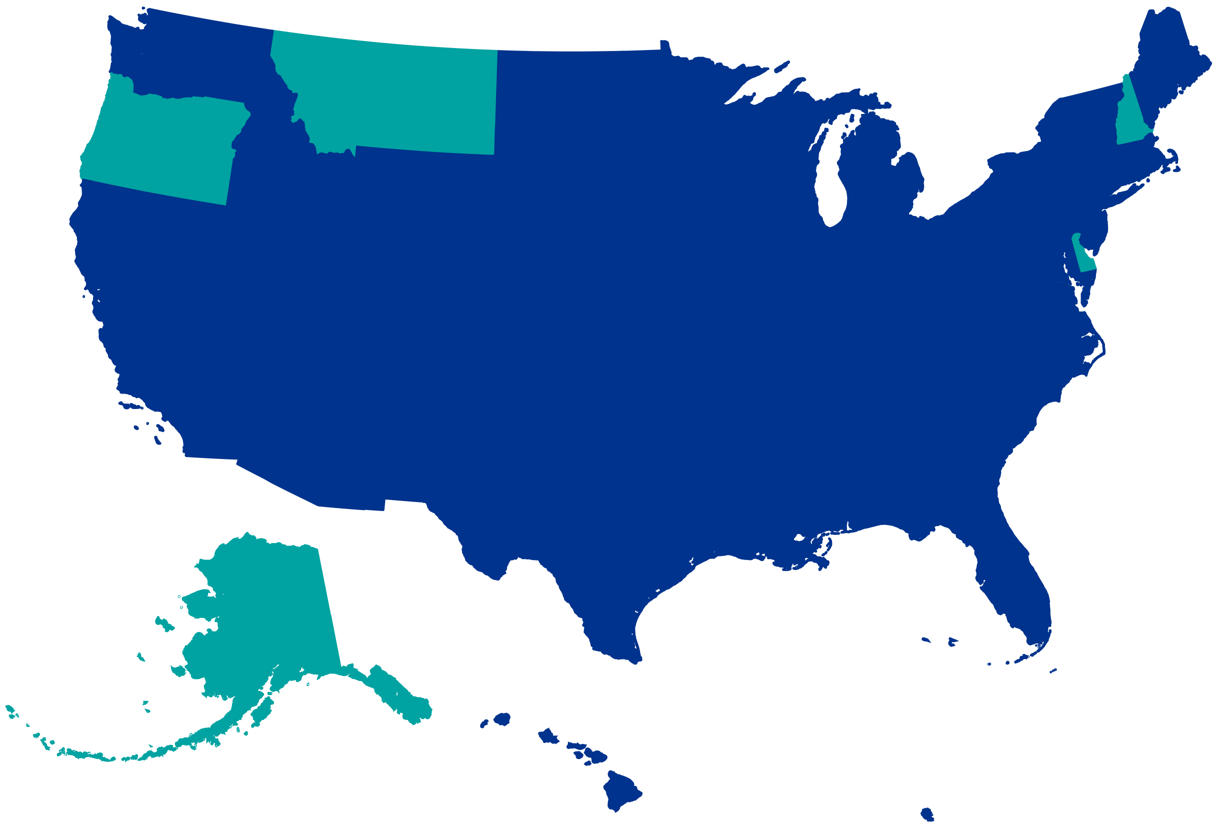
- The use tax acts as a complement to the sales tax and is imposed in a situation where no sales tax was collected by the vendor and paid by the purchaser.
- Use tax is generally imposed on the use, storage, consumption, or importation of tangible personal property or services in the state, where no sales tax was paid.
- Originally the use tax was intended to discourage purchasers from buying from vendors (out-of-state) who did not have to collect sales tax because they did not have sufficient contacts in a particular state. “Buy Local!”
- The use tax imposes a tax equal in amount to the sales tax that would have been imposed on the sale of the property or services in question if the sale had occurred within the state’s taxing jurisdiction.
- The purchaser generally bears the burden of the use tax.

Which states impose sales and use taxes?

45 states and the District of Columbia, plus local governments, impose a type of sales tax.

Only 5 States do not impose a sales tax — "NOMAD" States:

- New Hampshire
- Oregon
- Montana
- Alaska
- Delaware



Where does a sale occur?

- There is not a uniform sourcing rule across the US but generally it is where tangible goods are delivered or where a service is performed or the benefit is received.
- It is critical to “source” the sale to the correct jurisdiction because tax rates vary drastically among states and localities.
  - For example, a sale that is “sourced” to the City of Chicago is 10.25 percent consisting of:
    - Illinois state sales tax is 6.25 percent
    - County sales tax 1.75 percent
    - City sales tax is 1.25 percent
    - Regional Transportation Authority rate is 1 percent
  - Outside of the jurisdictional boundary of the City of Chicago but within Cook County, the tax rate may only be the state and the county level tax.
  - For sales that are shipped, retailers in the US generally use tax rate software (either within their tax engine or within compliance software) to determine what tax rate is owed based on data elements gathered during the sale (i.e. “ship to” address). Over the counter sales are based on the rate of the store location.

What is taxable?

- Generally, states levy tax on all tangible personal property unless it is exempted by law, and tax specifically enumerated services. States such as South Dakota, New Mexico and Hawaii have a very broad levy of tax on services.
  - While most states have similar definitions of tangible personal property (property that can be seen, weighed, felt, measured), there is no uniformity around what is subject to sales tax in a state.
- There are also not uniform definitions in the state. It is common for states to exempt the sale of food but tax prepared food. However, it is possible for something to be considered “food” in one state but not “food” in another state due to the applicable definition.
- Because each state has unique “product-based” exemptions, it is common for sellers to use tax software to “map” the products they sell into categories. The software assists in determining whether the particular product is taxable or exempt depending on the jurisdiction where the product is to be shipped.
- There are also many “use-based” exemptions. For example, manufacturers in many jurisdictions are allowed to purchase equipment used in the manufacturing process exempt from sales tax because those states want to encourage manufacturing in their state.
  - Used-based exemptions generally require the seller to maintain exemption certificates from their purchaser.

Who is Taxable?

- States often have exemptions or exclusions from sales tax in their state based on the type of purchaser making the purchase.
- All states allow resellers to claim an exemption for purchases made for resale.
- Most states allow an exemption for non-profit organizations such as churches and charities. These organizations generally are required to be determined as a non-profit organization by the US Internal Revenue Service.
- Purchases made directly by the US federal government are not subject to sales tax in any states.
- Sellers are required to obtain — and maintain — certificates from the purchaser at the time of sale that includes required data elements such as the name and address of the purchaser, the purchaser's sales tax account number and the reason for the claimed exemption.
  - Some states require their specific state exemption certificate
  - Many states will accept the Multistate Tax Commission's Uniform Resale Certificate — but only for purchases for resale: https://www.mtc.gov/Resources/Uniform-Sales-Use-Tax-Exemption-Certificate
  - Many states will accept the Streamlined Sales Tax Exemption Certificate: https://www.streamlinedsalestax.org/docs/default-source/forms/exemption-certificate.pdf

How Much is Taxable?

— The tax base that sales tax and use tax is levied on is generally defined by states as “sales price” or “purchase price.”

— The amount is based on the consideration paid by the purchase which includes cash, credit, barter, exchange, etc.

— States vary on what else is part of the tax base, such as

  — Delivery Charges
  — Discounts
  — Rebates
  — Trade-ins
  — Other taxes (e.g. tire fees, used oil fees, excise taxes)
  — Services necessary to complete the sale — e.g. even though a state may not tax installation services, if the services are sold as part of tangible personal property and are deemed required as part of the sale then those services become taxable.

— When taxable and nontaxable services are sold together for one non-itemized price — i.e. as a “bundled transaction” — then the entire sale is generally subject to sales or use tax.

Who is required to register and collect tax as a seller?

— Sellers that have a physical presence in a jurisdiction, either through employees, independent contractors, or property have always had an obligation to register for sales and use tax in that jurisdiction unless some specific exclusion applies.

— Since the *South Dakota v. Wayfair* decision by the US Supreme Court in June 2018, all but two states (Florida and Missouri) have passed legislation, rules or issued guidance that sellers who make a certain volume of sales (between US$100,000 and US$500,000 annually) in a state are required to register and collect tax in a state even though the seller may have no physical presence in the state.

  — These rules may also apply in jurisdictions where local governments administer taxes as well (e.g. Louisiana, Alabama).

— Sellers that do not have a physical presence in the US are also subject to these laws if they meet the sales volume thresholds — there is no treaty or other protection.

— States have also passed "marketplace facilitator" legislation that requires a marketplace facilitator to collect, report and remit taxes for sales through a marketplace.

  — Generally a marketplace facilitator is a person that operates or owns a marketplace who contracts with marketplace sellers to facilitate sales of their products.

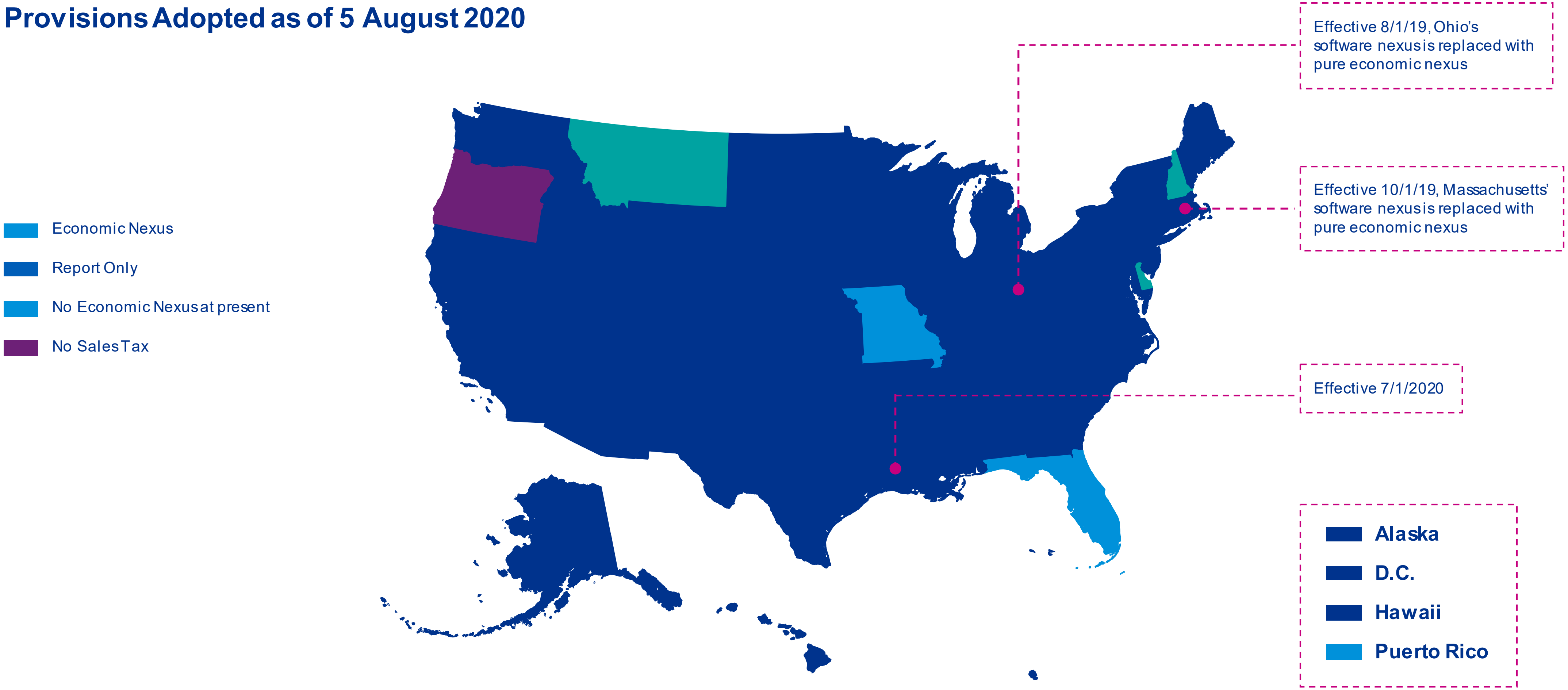
  — "Marketplace" often defined to include a physical or electronic place, including an internet website.

  — Consideration for the service of facilitation may or may not be required.

  — What it means to "facilitate sales" can vary widely.

Economic nexus for sales and use tax

Provisions Adopted as of 5 August 2020

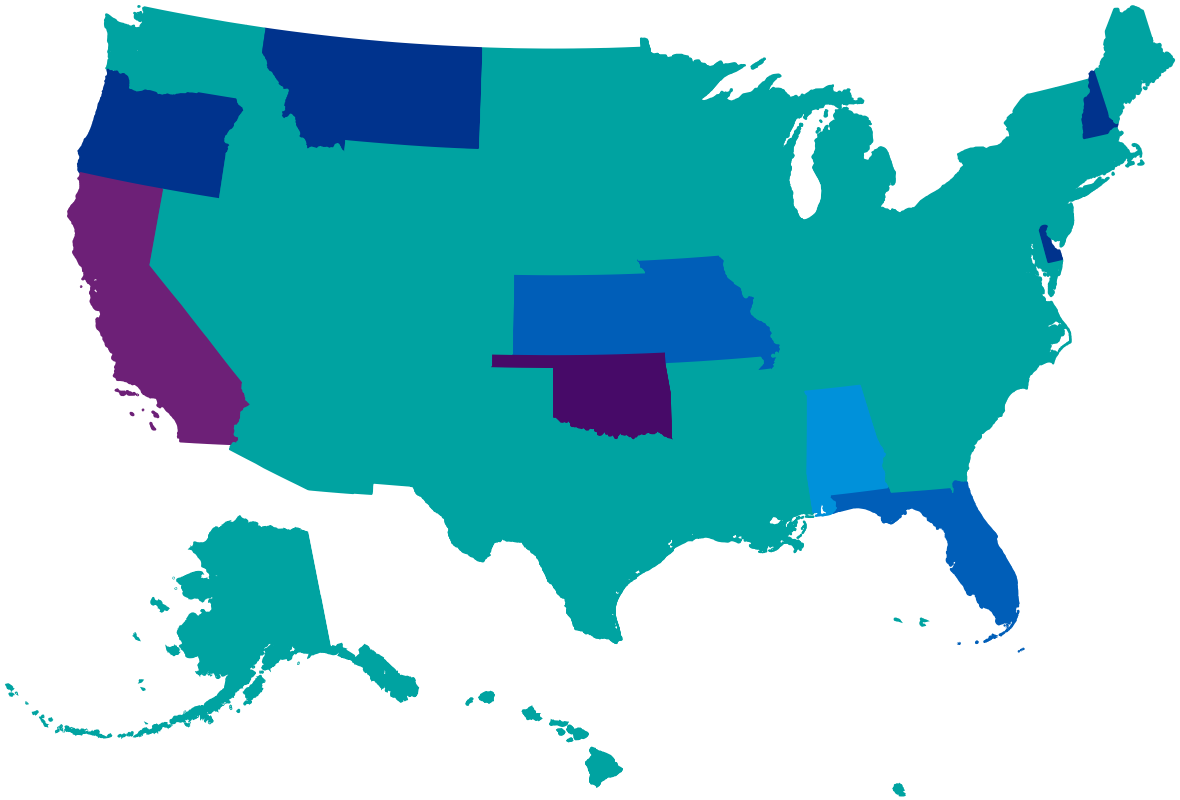


Alaska does not have a state sales tax, but certain localities impose local sales taxes. Many localities have adopted economic nexus for remote sellers and marketplace facilitators.

Marketplace requirements

As of 1 January 2021

- Currently have marketplace requirements
- Collect-or-report
- No marketplace provisions
- No Sales Tax



- Alaska
- Hawaii
- District of Columbia

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Top compliance and audit issues

Top compliance challenges for sellers

The US landscape for sales and use tax causes complexity for sellers in the following areas:

- Managing exemption certificates.
- Ensuring proper registration for the correct jurisdictions (i.e. tracking movement of employees and property for purposes of determining “physical presence” or tracking volume of sales for purpose of determining “economic nexus” presence.
- Properly characterizing “what” is being sold — this is particularly difficult in the area of digital goods and products, streaming content, software, software as a service, infrastructure as a service and technology related services.
- Properly capturing data to determine where a sale should be sourced and to apply the correct tax rate for the location where a sale is sourced.
- Dealing with issues such as “caps” (i.e. only a certain amount of the sales price of an item is subject to tax), “thresholds” (i.e. clothing with a sales price of less than US$250 is exempt), and “sales tax holidays” that may last on specific items for specific time periods (i.e. back to school).
- Tracking pre-payments for sales tax (submitting tax payments prior to due date of return) and tracking credits for overpayments.
- Keeping up with the volume of returns for the number of jurisdictions on a monthly basis.

Top compliance challenges for purchasers

Businesses pay a significant amount of sales taxes on capital inputs and expenses. In a report released by Council on State Taxation in October 2020, businesses paid over US$700B in state and local sales taxes, comprising approximately 21.3 percent of total state and local tax revenues collected.

Complexities by purchasers — who are obligated to remit use tax where sales tax is not collected — include:

- Ensuring sales tax was collected at the correct rate and the correct jurisdiction on taxable purchases
  - Following the *Wayfair v. South Dakota* decision, more sellers are registered to collect tax in multiple jurisdictions, but it does not necessarily mean that those sellers are properly calculating sales tax.
- Ensuring no tax was collected on exempt purchases
  - This is a major issue for manufacturing, telecommunications, health care and other industries that have exemptions based on how a product is used.
  - Where sales tax is erroneously collected, purchasers must pursue claims for refund from the taxing authority. In some jurisdictions, the purchaser must pursue the claim through the seller that collected tax — in other jurisdictions, the purchaser can pursue the claim directly.

Top audit issues for sellers

1. Exemption Certificates.
   - States place a burden of recordkeeping and of care on a seller to only accept properly completed exemption certificates.
   - If the seller mistakenly accepts a certificate or does not have the certificate on hand when an audit is undertaken then, unless the seller is able to obtain the properly completed certificate, the seller is liable for the tax that should have been collected on the sale.
   - This can be an expensive proposition when “exempt sales” create an error rate that is extrapolated across the entire sales population.
2. Misclassifying a product or service.
   - E.g. If a state exempts food but taxes candy, and the state believes that the retailer sold candy because it had erroneously classified the product as food, this also creates major problems.
   - As states continue to evaluate taxation of digital and technology products, sellers of these types of products have a major risk.
3. Sourcing a sale to the wrong jurisdiction or collecting tax at the wrong rate.
   - E.g. If the sales data for customer’s address is not sufficiently defined, then the seller may collect tax at the wrong rate or remit tax to the wrong jurisdiction.
4. Discovery by taxing authorities based on data matching that shows seller activities in a jurisdiction where the seller is not registered.

Current trends in state sales tax

Digital goods and services

Taxation of digital goods

— Majority of states have moved to tax digital goods — e.g., e-books, downloaded movies, digital audio products.

— These are generally tax substitutes for goods previously sold only in tangible (otherwise taxable) form.

— Some major states — New York, Florida, California — do not tax such products currently.

— Complexities lay in defining/classifying items and sourcing to the place of use.

Taxation of streaming services

— States are increasingly taxing streaming services, i.e., digital goods that are not downloaded to user's device.

— Fewer states do so than tax downloaded digital goods.

— Greatest challenge is that states take varying approaches to imposition which can substantially increase risk.

Taxation of digital services

— Uneven taxation of "cloud" products and services; approaching half of the states that tax SaaS — without necessarily defining what is SaaS.

— Challenge in sourcing and apportionment (i.e. allocating use of software among various jurisdictions).

State and local taxation of streaming services

Impose new taxes specifically on streaming

- E.g., Iowa enumerates “pay television” services as taxable
- In 2018, the legislature amended the law to read “pay television, including but not limited to streaming video, video on-demand, and pay-per-view

Streaming as a digital product

- Ohio and Tennessee impose sales tax on specified digital products (defined to include audio-visual works) that are provided for permanent use or less than permanent use, regardless of whether continued payment is required

Utility Taxes or other communications taxes

- Pasadena, CA has amended its utility user tax ordinance to impose the tax on “all services related to the providing of video programming”
- Florida imposes its Communications Services Tax on certain communication services, including “the transmission, conveyance, or routing of…video,” and rulings have deemed streaming services to be subject to CST.

Amusement taxes

- City of Chicago, City of Evanston
- Imposes the amusement tax on any video streaming, audio streaming, or online games delivered electronically to mobile devices, and any paid television programming, whether transmitted by wire, cable, fiber optics, laser, microwave, radio, satellite or similar means

2020: Digital advertising/digital services tax proposals

DC

- Would have imposed reduced sales tax of 3 percent on “digital advertising services” and “personal information” services as defined
- No sourcing provisions
- Pulled from Budget Support Act after significant outcry from business groups

Maryland

- Multiple bills would have imposed a “Digital Advertising Gross Revenues Tax” on annual gross revenue derived from digital advertising services
- While House Bill 732 was vetoed by the governor on 7 May 2020, the veto was overridden on 11 February
- House Bill 732 is now law in Maryland and the new digital advertising services tax is effective for tax years beginning after 31 December 2020

Nebraska

- LB 989 would impose sales tax on gross receipts derived from “digital advertisements”
- LB 946 would create a presumption that all services are taxable unless a specific exemption applies
- Nebraska’s legislative session reconvened on 20 July and is scheduled to adjourn on 13 August. To date, there is no movement on the bills that would impose tax on digital advertising services

New York

- AB 8056 would impose a tax on annual gross revenue derived from digital advertising services
- AB 9112 would impose a 5 percent tax on the gross income derived from sharing data
- Multiple bills would impose sales and use tax on sales (except sales for resale) of digital advertising services
- New York in session through 2020

2021: More digital and information services tax proposals

Washington

- House Bill 1303
- Would impose Washington B & O tax on receipts from sale or exchange for consideration of personal information
- "personal data" is any information that is linked or reasonably linked to an identified or identifiable natural person
- Would apply to Washington receipts

Connecticut

- HB 5645 would impose a gross receipts tax on social media companies on the apportioned annual gross revenue derived from social media advertising services in the state
- HB 6187 would impose a 10 percent tax on the annual gross revenues derived from digital advertising services in the state for any business with annual world-wide gross revenues exceeding ten billion dollars

Indiana

- HB 1312 would impose imposes a social media surcharge tax on revenue from social media advertising services

New York

- SB 302 and AB 734 would expand the sales to include "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services which markets or promotes a particular good, service, or political candidate or message
- Other bills would amend the income tax specifically for social media companies and data sharing

Questions?

Q&A

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Thank you

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