

Sales Tax Compliance | Common Pitfalls & How to Avoid Them

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Ryan Lauer:

Today we're here to talk about sales tax. I'm Ryan Lauer. I'm a Senior Manager in our tax consulting group here at Barnes Dennig, and I'm with Cheryl Ganim, a Director in our tax consulting group who specializes in sales tax. Cheryl, thanks for being here.

Cheryl Ganim:

Oh, thanks, Ryan.

Ryan Lauer:

First question is what businesses pay sales tax and what industries need to be concerned?

Cheryl Ganim:

Businesses that pay sales tax generally are selling items at retail. Businesses that really need to think about sales tax might be all businesses because businesses who are, say manufacturers and aren't selling at retail, may have use tax, which is where they've purchased something, sales tax wasn't charged by the vendor, but it was still a taxable transaction. And so, it's incumbent on that business to self-assess use tax, and pay it.

Ryan Lauer:

Got it. In 2018, the Supreme Court ruled in favor of the state of South Dakota and that required Wayfair to start collecting sales and use tax from its customers. How did that change the game for sales tax?

Cheryl Ganim:

It changed the game across the entire country. So, before the Wayfair Supreme Court unprecedented case in 2018, businesses had to have a physical presence in a state in order for that state to subject the business to its sales tax regime, which means that the company had to basically have bricks-and-mortar people in a state in order for the business to be required to put sales tax on their invoices, charge the

state tax, collect the money, send it back to the state. What South Dakota's winning the Wayfair case did was set the precedent for all of the other states to change their rules, and basically says that if you have an economic presence in our state, you're benefiting from our state. In order to do business and make money, we are going to be able to pull in all of these out-of-state businesses to collect our state's tax and remit it. And so, it enabled states to generate income from businesses that have maybe never been in their state.

Ryan Lauer:

And are the filing requirements the same in every state?

Cheryl Ganim:

The sales tax filing requirements are not the same in every state. Some states have a different threshold for economic nexus. So, most states, if you have \$100,000 in sales, you're pulled into that state for sales tax compliance. Other states might have a \$500,000 threshold before you have to start filing returns, registering your business there. Other states have filing frequency differences. Some states have collected local taxes on the state tax return, but there are a few handful of states where local jurisdictions have home rule, where they have their own sales tax forms, a separate filing than the state filing. So, there are differences. There are also differences in the taxation of certain items that you might sell. One state may tax it differently than another state.

Ryan Lauer:

Sales tax exemptions, what are they? Who needs them? And does it matter by industry?

Cheryl Ganim:

Right. So, a sales tax exemption is a form that the state allows you to use in order to buy tangible personal property or materials. If you're a manufacturer, for example, that are exempt, meaning you don't pay tax on the item when you purchase it, you may be manufacturing using those materials. So, the sales tax is really paid at the end of the final transaction by the end user. So, the exemption certificate is something that the purchaser gives to the vendor in order to buy something tax-free.

Ryan Lauer:

Okay. And you said they give it to the vendor. Does the vendor just hold onto this form? Do they file it with the state? What do they do?

Cheryl Ganim:

So, the vendor will hold onto the form. They should keep that exemption form in their files. Usually we advise our clients to refresh on those once a year or so to make sure that the business may have changed ownership or gone out of business. It's a good idea to have those current.

Ryan Lauer:

Yeah. When it comes to sales tax, what are the big pitfalls that you see?

Cheryl Ganim:

Well, you just mentioned sales tax exemptions. That's a big pitfall. A lot of companies, their sales force is the first in line with transactions with the customer. And so, the sales force may not be thinking about sales tax. They're thinking about making a sale and not collecting exemption certificates from their customers. So, if the business doesn't have a process in place to collect those exemption certificates and they're also not charging sales tax, that's an area of exposure under an audit. And so, since audits can go back in time several years, that sales tax exposure can compound over time. Other areas that we commonly see in sales tax audit are purchases made on credit cards where the vendor didn't charge tax and it just isn't caught because you might not be looking at an invoice. It's a credit card statement. Also, common pitfalls are items that are intangible but are subject to sales tax, like software licenses. So, you might not think it's subject to tax, it's not tangible personal property, but it's taxable. The states say it's taxable. So, that's an area of low-hanging fruit for auditors.

Ryan Lauer:

Now, you mentioned collecting all these exemptions. What are just some other best practices businesses can put into place around sales tax?

Cheryl Ganim:

Great question. So, definitely doing a refresh on what clients you might be missing, your sales tax exemptions. Your internal best practices for collecting those in the first place, for setting up your clients as taxable or exempt, which is a default usually in your software. And probably the main thing that I would advise is that you at least annually go over your sales by state to decide if you have triggered nexus, economic nexus with the state where you have a new filing requirement.

Ryan Lauer:

Yeah, and I think you can't just assume every year is the same. The business could enter new states, it could be completely different.



Cheryl Ganim:

That's right. And then so conversely to that, you might have an opportunity to stop paying tax or filing in a state where you're not going to do business again, and you can withdraw.

Ryan Lauer:

Sales tax audits, no one wants to deal with it, but they're a reality. Are there any practices that folks can put into place or any other things that we can consider just around the sales tax auditors?

Cheryl Ganim:

Sure. doing a reverse sales tax audit is a good idea to do that inside of your finance group and also to teach and train your accounts payable staff and your sales force, even though they're not going to be happy to do an exercise like that most likely. But having them have a little bit of education on the sales tax process, so they know to help get those exemption certificates, to have appropriately prepared invoices.

Ryan Lauer:

And with the flurry of all the rule changes that have occurred in the last several years, how can a business keep up with this, meanwhile, they're trying to run their own practice?

Cheryl Ganim:

Right. Probably a lot of companies went from filing one state sales tax return before 2018, maybe their home state to filing sales tax returns with the advent of everybody selling, being able to sell online. And now everyone since COVID buying online. As company may have gone from filing one state to potentially all the states that have a sales tax. So, the compliance burden has gotten really challenging, I think for a lot of businesses, especially small businesses. So, things that they can do are to really put best practices in place with having invoices prepared correctly, automating as much of the process they can, reviewing their exemption certificates on at least an annual basis and training their staff. And I think those would be the main things. Probably most important thing is to look at your sales by state at least annually to find out if you have a new compliance requirement.

Ryan Lauer:

Got it. With automation, is there anything there that can be used to reduce the burden of business employees trying to keep up?

Cheryl Ganim:

There is. So, one way that companies can put some automation into their sales tax compliance process, instead of doing all of that work by hand every single month, is to use sales tax software products that will connect to their accounting systems. And there can be some automation to populating sales tax returns every single month. And what that does is take that manual process out of the hands of their finance people, so that they can be freed up to do other more value-added work. And so, that can be a service that's provided to the business by Barnes Dennig.

Ryan Lauer:

Right. So, with all the changes that have been occurring in the sales tax space, a lot of companies have been moving into the automation space and trying to help businesses out. What are some of the benefits? What are some of the pitfalls?

Cheryl Ganim:

Right. So, some of the benefits of automating your sales tax process are that you may be working with a professional who has sales tax expertise, but especially beneficial is that you're taking that manual labor-intensive process off of your finance team every single month, and that frees them up to do more value-added work. Some of the pitfalls are, that there's some complexity in setting up that automation and connecting a business's accounting software, mapping that correctly to the tech software. And on top of that, it's understanding which one of your products is taxable in which state, and mapping that. And then lastly, making sure that your customers are set up correctly in the taxable and exempt categories. Some customers may buy things taxable and exempt, so you have to understand how to handle that in the system.

Ryan Lauer:

Yeah, I mean, and I think from our experience too, garbage in, garbage out. How long can it take for a business to get set up with one of these companies to start using successfully?

Cheryl Ganim:

Great question. It depends really on the size of the company, how many invoices and customers they have in a month. So, it could take up to two months for a company that's filing in every state and might have dozens and dozens of products, it could go quicker than that for a smaller business.

Ryan Lauer:

And what's the ideal size of a company or maybe perhaps the footprint is the better question of someone who can be using some of these services?



Cheryl Ganim:

Sure. I would say due to the cost of tech software automation for, it's probably in the 15, 20-state range where you would want to start considering that versus handling that manually.

Ryan Lauer:

And using that software, potentially what time savings could a business see perhaps down the road, a few months?

Cheryl Ganim:

Yeah, I would say that as a business grows already having that in place before you're at the filing in every state stage, that's going to help you to be able to add states slowly instead of having to handle that all at once. It's going to save probably days of time of employees who are handling sales tax manually: days, could be a week depending on how many returns you have to file. But along with that comes hopefully the reduction of notices from multiple states and other maintenance that has to happen in the sales tax software. The idea is that the automation pays for itself in ways.

Ryan Lauer:

Thanks, Cheryl for sharing your insights. If you have more questions or would just like to set up a call around sales tax, visit our website at barnesdennig.com. We're here to help.