Benefits and Limitations of Sales Tax Automation

By Judy Vorndran*

Judy Vorndran discusses the benefits and limitations of sales tax automation since Wayfair and offers some pointers on choosing the software program that works best for you.

Sales tax has been with us nearly a century since first introduced in the 1920s. West Virginia was among the first states to enact a broad-based sales tax that still exists today—and the state taxes just about everything including services.

The way we buy, legal developments, access to Wi-Fi, and door-to-door delivery services (FedEx, USPS, and others) have increased remote sales, shifting the revenue basis away from brick and mortar resellers and eroding the nexus, or connection, that once created the "physical" basis for sales tax obligations.

States have since moved to expand the reach of sales tax, upending our understanding of what constitutes a sales tax obligation and where. In the wake of the 2007 economic crisis in the United States that put several states at risk of bankruptcy, states across the nation renewed their interest in sales tax as a source of revenue. South Dakota and 15 like-minded states enacted economic presence thresholds for its potential to fill coffers. Economic nexus requires remote sellers to collect and remit sales tax if they exceed certain thresholds in a state or local tax jurisdiction.

Challenged in court, the South Dakota statute was upheld by the U.S. Supreme Court in *Wayfair Inc. v South Dakota (Wayfair)* on June 21, 2018, thereby allowing both economic and physical presence thresholds to co-exist. Following the seminal decision, all but two states (Florida and Missouri, as of the writing of this article) that impose sales and use tax moved quickly to require sellers to collect sales tax on online purchases, and the last two states are closing the distance. These changes, and more, have created the need for all sellers, resellers, wholesalers, manufacturers, and service providers to take a closer look at who they were, where they are and how they need to comply with sales tax laws and regulations.

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Shifting Views

Wayfair caused a shift in thinking about state and local tax (SALT), upping compliance awareness across the nation and internationally. Revered publications including the New York Times, the Washington Post, the Wall Street Journal and other media outlets routinely tout the necessity for sellers to pay attention to sales taxes.

It's been a wake-up call to the many companies that may already have had nexus associated with multistate sales and were non-compliant due to any number of challenges—the confusion in dealing with over 10,000 taxing jurisdictions, nuanced laws, complicated rate structures, and technology. Nuances such as "one-day" nexus rules commonly put businesses in non-compliance. Prior to *Wayfair*, California and Michigan imposed a sales tax duty on companies with personnel that visited the state for as little as one day to conduct sales, training, support, installation or other customer-centric activities. Many companies that were unaware or willingly chose to ignore this sales tax obligation banked on not being caught rather than paying the high cost and burden of complying with tax laws due to, what I call, "popcorn" nexus.

While technology touches every transaction in a business, it requires handlers that understand the laws, rules and subtleties. Whether these knowledge resources are in-house or outsourced, make sure your team is fully equipped with the knowledge and tools they need to meet compliance and reduce risk in this ever-changing area of tax.

The stakes, however, are high for key personnel at companies. Sales tax, like payroll tax, is a fiduciary tax. The money collected belongs to the government. Taxes must be collected and held separately from company cash flow before being forwarded to the government. When mistakes happen, a person or persons known as "responsible parties" within a company, typically business owners and company executives, may be personally liable for sales tax that is not collected and remitted properly.

With the risk *Wayfair* has presented, companies have moved to find ways to simplify sales tax with automation. The largest companies in the nation automated sales tax early, justifying the high price of that automation by the even higher cost of non-compliance. Being caught by government auditors has severe penalties, swaying companies that could bear the high cost of automation to comply from the outset.

Tax automation for early adopters typically cost $75,000 to $250,000 and upwards for the development of the connectors, or APIs, needed to integrate with the various general ledger, ecommerce and other invoicing systems in the market. There are over 3,500 financial accounting systems—some you've probably never heard of, but enough companies are using them that they continue to exist. Some have better marketing budgets and are widely known like QuickBooks, NetSuite, Sage, SAP, Oracle, and Zero. Few of the early adopters of sales tax automation are willing to walk away from the sizable investments they've made in automation even as more sales tax software options have emerged in the marketplace.

Sales tax automation has come a long way in the past 40+ years from when it first started. Now, even the smallest multistate businesses and startups have access to sales tax automation options that lower costs and ease the burden of compliance. With so many rates and jurisdictional sets of rules for sales tax compliance in the United States, it makes sense to outsource what you can to an automation product.

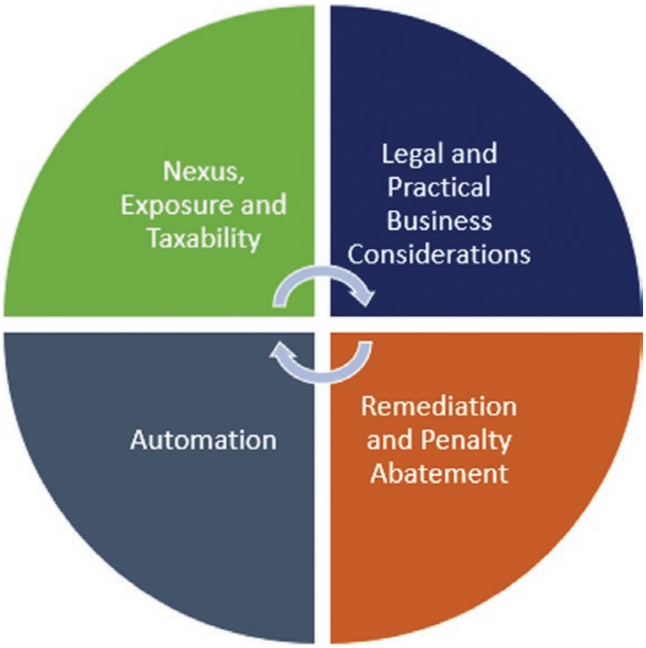
But automation is a technology tool and not a "set it and forget it" catch-all for sales tax compliance. Sales tax compliance is complicated and multilayered, requiring management to peel back the onion by jurisdiction (state, municipal, home rule, special district), activity, and type of tax before making key decisions around who you are, where you are, and how best to comply.

Technology alone lacks the indispensable insights and advice management needs to make these decisions and properly manage sales tax from registration to remittance and audit to penalty resolution. There are limitations as to what sales tax automation can do, necessitating a deep dive into a company's nexus footprint and approach to compliance as well as internal resources all before a business vets, uses, and thrives with these technology tools in 2020 and beyond.

Role of Automation

Sales tax automation tools are prospective in nature, supporting ongoing sales tax compliance going forward.

CHART 1.



They do not fix instances of non-compliance or account for what has been done in the past. For that, businesses need a broader lens to understand past, present and future activities that impact sales tax liabilities and create risk, including:

- Analyzing nexus, exposure and taxability;
- Assessing legal and practical business considerations in determining where to comply;
- Negotiating remediation and penalty abatement proceedings; and
- Automating sales tax to efficiently manage prospective compliance (*see* Chart 1).

Data software companies are not SALT advisers; their primary role and incentive is to get businesses to buy software licenses. Businesses can't solve SALT compliance with software alone and are at risk of not getting the professional services advice they need if they solely rely on sales tax automation tools. Businesses without experience and wherewithal in-house may not know that these software companies are either not providing SALT consulting regarding who you are, where you are and how you must comply or providing limited advisory services solely around sales taxes, which can be a trap for the unwary.

Working with a qualified sales tax consultant through each facet of compliance, management can make key decisions about compliance. Once there, you are ready to reap the benefits of automation (*see* Table 1).

TABLE 1.

Sales Tax Compliance	Where Automation Can Help
Know who you are, where you are and how you must comply	
Register to collect and remit sales tax	
Calculate correct sales tax amounts	✓
Track and manage exempt sales	✓
Remit sales taxes to the tax authority	
Manage resale and exemption certificates	✓
Increase efficiencies	✓
Free up internal resources	✓

Vetting Automation

When it comes to sales tax automation, there is no such thing as plug and play. Among other management duties, it is the business' responsibility to map products and services appropriately, tag them for automation, and review invoices for proper rates and rules.

Pros and cons exist in each software option that need to be assessed based on the unique circumstances of each business. Nuances exist that may make any one solution insufficient for your business needs, a fact that businesses will want to know before they make the investment.

Vertex, OneSource, Sovos (Taxware), CCH and Avalara seem to be more broadly recognized and have large adoptions. They offer robust systems for tax rates, growing lists of APIs for easier integrations, and additional modules for end-to-end sales tax automation.

Taxify, TaxCloud and TaxJar have easier integration solutions and often are a less expensive alternative to OneSource, Vertex and Avalara but, functionality can be limited to specific jurisdictions and tax decisions and they do not all operate internationally.

The general ledger system you use or where you sell may limit your options. For example, TaxJar doesn't deal with the 70+ home rule cities in Colorado, which should eliminate the option for vendors that sell into Colorado.

Choose Wisely

There are many software vendors and features to choose from, making the selection process difficult. Again, none are plug and play; all require that businesses make key decisions in the selection and maintenance of the automation solution. Hiring a product-agnostic expert can help you vet each option, choose the right solution for your operations,

TABLE 2. HIGH-LEVEL COMPARISON OF SELECT AUTOMATION OPTIONS AND FEATURES*

Avalara	Vertex	TaxJar	Other (Sovos, Taxify, TaxCloud, DACENSO, Intuit ProSeries Tax, OneSource, CCH Sales Tax, etc.)
• Calculations, exemptions, filing and remittance, and international tax compliance • Tax calculation: AvaTax • Tax document management: CertCapture, VendorCapture, ExciseCapture (only familiar with CertCapture) • Tax filing: TrustFile for those doing own returns • Vacation rental tax: MyLodgeTax, rental property owner • Licenses, permits, and registrations: Avalara Licensing	Calculation: O Series 9.2 Service Release (on-premise, on-demand) • Vertex Cloud (Exemption Certificate Wizard enhancements) • Tax Content (Customs & Duties, Environmental Fees) Compliance • Vertex Returns-Global (New VAT Compliance cloud solution) Integrations • ERP, Telecommunications • E-commerce • Procurement	• Offers sales tax calculations, reporting, and filing • Does not cover consumer use tax or VAT • Generally lower price • Designed for e-commerce sellers • Aggregates sales data and simplifies sales tax returns process	• Product differences that may limit functionality • Integrations and connectors vary • Pricing differentials

* Representative example of offerings only. Software offerings change rapidly. Check with individual providers for current offerings and descriptions.

and implement appropriate management procedures for compliance. Here are some steps to getting it right:

- Narrow down your choices to 2–3 real options and assess each for strengths and weaknesses relative to your business.
- Deliberately select end-to-end or *ala carte* solutions (Avalara's Cert Capture), or even separate vendors (DACENSO's exemption certificate monitoring system), for how they will integrate with your legacy systems.
- Implement process for purchase, installation, and management.
- Assign who manages and is accountable for sales tax compliance, in-house or outsourced; don't set it and forget it!
- Overcome installation obstacles.
- Learn to use automation technology efficiently, monitor reports, and get the most out of your choice in tools to free up resources.

Creeping Nexus

Wayfair expanded the concept of nexus and duty to collect and remit to remote sellers. Now, Wayfair is leaking into additional areas as states greedily reach for more. Income taxes are the next frontier, ensuring that state and local tax will continue to be in flux throughout 2020.

Getting and staying compliant starts with understanding the trends, traps and what comes next as the number of activities that trigger nexus expands, including:

- Factor presence,
- New business activities,
- How laws vary by state,
- Impact on income, payroll and other taxes,
- Relevance of P.L. 86-272, which protects the mere solicitation of sales for a product in a state from creating an income tax filing requirement,
- Selling through online marketplaces,
- International sellers, and
- Delivery and distribution.

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ENDNOTE

* The author has helped 1,000+ taxpayers figure out who they are, where they are, and how best to comply with tax duties and is passionate about simplifying sales and use tax for all stakeholders. Judy can be reached at *jvorndran@taxops.com*.