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Sales Tax Complexities: What They Are, Why They Exist, and How to Overcome Them

March 28, 2023

As wild and wacky as they are, the complexities of sales tax are no joke. In this guide, we give you a look at some of the most perplexing complexities of them all, the reasons why they exist, and the ways to overcome them.

The not-so-funny complexities of sales tax

Next time you fancy yourself a bagel in New York, be prepared to dish out a few more cents if you want it sliced.

No, seriously.

Believe it or not, sliced bagels cost more than unsliced ones in New York state.

Silly, right? But why?

Oh, you already know, don't you? That fun little thing called sales tax.

Turns out New York state deems sliced bagels prepared foods, which carries a sales tax. Though this might be no big deal for consumers looking for a quick breakfast, it's one of many complexities that can wreak havoc on a company's finance operations if they're not prepared with the most up-to-date information and innovative technologies.

And that information changes a lot. "There were 32,000 sales tax changes in the last couple of years alone. Being able to keep up with that is really tough," says George Padilha, Strategic Alliance Manager at Avalara.

Thirty-two thousand. Woof. That's a lot to learn (I'm out of breath just thinking about it).

3 weird and wacky sales tax (fun) facts

Donuts in Texas

If you buy five donuts or less in the state of Texas, it's taxable. However, if you buy six donuts or more, there's no sales tax.

I donut about you, but I don't see myself having to pay taxes on donuts next time I'm in the Lone Star State.

Hershey Bars in Indiana

If you buy a Cookies 'N' Creme Hershey bar in The Hoosier State, it's tax-free. However, a regular Hershey bar is taxable.

Here's why: A Cookies 'N' Creme Hershey bar is tax-free because it contains wheat flour, and wheat is a subsidized item in Indiana, which makes it tax-free.

Snow Removal in Ohio vs. Illinois

The sales tax complexities extend beyond products and apply to services, too. In Ohio, getting your snow removed is a taxable service. But just a couple of states over in Illinois, it's tax-free.

Confused yet? Me too.

Why is sales tax compliance so important?

The answer might seem obvious, but it's an important question to ponder, because the consequences of *not* complying with sales taxes are severe.

In short, complying with sales taxes is vital because there's no headache for a company quite like a tax headache.

"If there's one quickshot to a company that can set everything back rather quickly, it's a letter in the mail from the tax man," says Sam Blass, Sales Executive at Avalara. So, to set yourself up for success, Sam notes how it's important to get in front of tax compliance so you can pave a path that's void of roadblocks or speed bumps in the future.

To do so, he says companies need to ensure they're doing at least these three things:

- Accurately collecting from the very beginning
- Passing on a necessary sales tax to the end user
- Substantiating a sale with an exemption certificate

"These are all things that can allow you to avoid any of those future headaches when a state comes calling in regards to the sales tax compliance," says Sam.

From chaos to clarity: How one VP of Finance helped her company become sales tax compliant

In 2018, sales tax became much more complicated for companies overnight. That's because in June of that year, the United States Supreme Court ruled in a 5–4 decision in *South Dakota v. Wayfair, Inc., et al,* that states can generally require an out-of-state seller to collect and remit sales tax even if the seller has no physical presence in the consumer's state.

"Wayfair changed sales tax for so many businesses, including Chatmeter," says Nichole Peterson, VP of Finance at Chatmeter.

Fast-forward to 2020, and Nichole and her Chatmeter team discovered that they did in fact need to be charging sales tax.

Unfortunately, they had not been.

Chaos…commence.

A ‘classic situation’: Inside Chatmeter’s sales tax dilemma

“Historically, Chatmeter was a pretty classic situation,” says Nichole. “We only operated in one state, meaning we only had a physical presence in one state and therefore, did not believe we needed to charge sales tax because California doesn’t levy sales tax on SaaS services, which is 99% of our revenue. So, once we determined that Wayfair did in fact impact Chatmeter, we realized that this was a pretty complicated issue. We needed to unwind it.”

And unwind it they did.

Determined to make things right, Nichole and her team went to work—grinding day and night for two full years to get Chatmeter to a state of sales tax compliance.

Making it right: How Chatmeter became sales tax compliant

Nichole notes the first step in the process was to undergo a nexus study. They partnered with prominent accounting firms to look at:

- Where they had nexus

and

- What was triggering nexus
    - Was it transaction volume?
    - Was it revenue?
    - Was it the number of invoices they were sending?

This was just the beginning. Once Nichole determined where Chatmeter had nexus, they had to dupe the returns or go through the voluntary disclosure (VDR) process. In the VDR process, Nichole explains how you essentially “go to the state saying, ‘Hey, mea culpa. I messed up. I needed to be filing sales tax returns. I owe you ‘x’ dollars. And, if I pay you that and file this, you’re not going to come after me. You’re not going to charge me additional fines or penalties.”

In other words, the VDR process is a plea for forgiveness. A painful plea for forgiveness, that is.

Next, Nichole and her team had to go back to hundreds of clients and investigate whether those clients had self-assessed. When a company self-assesses, they go to the state with their sales tax returns and tell the state that they were supposed to pay sales tax on xyz invoices but did not.

If a company hadn’t self-assessed, Nichole had to find out if they were sales tax exempt.

If this process sounds a lot like putting a puzzle with missing pieces together, you’re on to something—because that’s exactly what it’s like.

“We needed to cover our bases and make sure all of our ducks were in a row,” says Nichole. “In addition, going back to these clients and trying to charge them the back sales tax was not an option. That is not how we would do business. So, we needed to cover those back sales taxes ourselves.”

The costs of becoming sales tax compliant

Of course, becoming sales tax compliant is a good thing. But when you realize you need to go backwards in order to do so, it becomes expensive, time-consuming, and downright intimidating. It's costly, and money, time, and energy that haven't been allocated toward such a process are now absolutely necessary to make things right.

"In a nutshell, it slowed down the business," says Nichole. "From a financial perspective, getting to a state of compliance—between the nexus study, back returns, the VDRs, and covering those back sales taxes—turned out to be a seven-figure project. Almost a million dollars diverted from business needs, such as investing in the product or marketing, had to be diverted to become sales tax compliant."

Such a hefty price tag will give anyone pause and make them think about shelving the project. Nichole is no different. "When you see big figures—$750,000–$1,000,000—it makes you want to choke. It makes you say, 'I don't want to do this.'"

But then Nichole reminds us of the golden rule of anybody working in finance—the ultimate responsibility of someone in her position:

"However, my role is to make the numbers right, not to make the numbers pretty."

The benefits of using software solutions for sales tax compliance

The waters of sales tax are murky. Navigating them, as evidenced by Nichole Peterson and Chatmeter's story, is tricky. And if you're not careful, they could even be life-threatening to your business.

I can hear my haters now: But, Tabatha, manually staying sales tax compliant is SO manageable.

Well, yeah, it is. But only up until a certain point.

Once your company begins to expand into multiple territories, whether it's states and/or countries, it's a different story. At that point, if you're still doing sales tax compliance without the help of technology, you're asking for trouble.

But avoiding compliance headaches isn't the only benefit of sales tax software—giving time back to your finance team to focus on other tasks is just as important, too. "Let's allow our finance and accounting individuals to put out fires elsewhere and not bang their heads against the wall filling out returns back to the states. Yes, there's some states' returns that are very easy and simple, and then there's other complex returns that can take hours out of your day to manage," says Sam Blass, Sales Executive at Avalara.

With that, let's get into how tech solutions keep you compliant and ease the burden of sales tax compliance on your finance team.

How sales tax compliance tech works

Every solution is different, but since we sat down with two of our friends from Avalara, they explained everything in reference to what they know best. Which is, of course, Avalara.

However, regardless of what your solution is, you should always start with understanding your nexus. Having that basic understanding down is crucial in getting the most out of a sales tax compliance software.

From there, it's all about letting your software take sales tax compliance off your plate.

As Sam explains:

"Leveraging a solution like Avalara allows a software to track your sales activities and any future obligation to register and collect new sales taxes. In the first episode, we talked about the complexities of local jurisdictions and aligning tax codes to zip codes and how there's not a clean overlap there. So, leveraging a solution like Avalara allows you to get a little bit more granular detail in regards to a rooftop-level calculation, so you're tracking your business activities for future expansion, to ensure that you're collecting everywhere you need to, you're allowing a team of experts to manage the content, the rules, and legislations that go into these tax laws to accurately calculate your tax rates based on the products and services that you sell. And then automating the remittance of that back to the states as well."

Keeping up with ever-changing sales tax laws with software

As discussed in the first episode with Sam and George, there are a lot of weird and wacky sales tax laws.

To add to the confusion, they vary from country to country, state to state, and even jurisdiction to jurisdiction.

And not only that, but they change a lot, too.

"As I mentioned in the last podcast, there were 32,000 changes in the last couple of years alone," says George Padilha, Senior Strategic Alliance Manager at Avalara. "The reason why is because there are 12,000 different taxing jurisdictions."

So, how in the world are you supposed to keep up with all of that? (I'll admit, even with the help of software, this sounds daunting at face value.)

But, as George explains, Avalara takes care of it all quite easily.

"In terms of technology, in helping advance and solve your sales tax problems, Avalara really does have a competitive advantage because we were built on the cloud and we have real-time updates as sales tax changes happen," says George. "So, by having us update in the cloud, it just makes everything a little more fluid and easier. Not to mention the fact that we have over a thousand connectors and bundles as well that can seamlessly connect a NetSuite ERP to something like an ecommerce store or a CRM, like Salesforce. So we can connect everything seamlessly and have a full picture of a solution for you in automated sales tax."

In conclusion: Sales tax is really confusing. Avoid problems by getting ahead

The ultimate solution to all the complexities posed by sales tax laws? Avoid the complexities in the first place.

For most growing businesses, that's only possible by investing in a software solution that takes most of the responsibility off your plate. Though it'll cost you a bit each year, it'll cost you a lot less than a date with the tax man.

Plus, the benefits of getting that time back for your finance team are immense. As George Padilha of Avalara explains:

"Have your finance department do something more productive, like streamlining your accounts receivable department or streamlining your accounts payable department, or trying to figure out a go-to-market strategy on a new product within a certain demographic. That's a more revenue-generating activity that would be a little more beneficial to any of your clients."