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Sales & Use Tax Update for Businesses

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Marketplace Fairness Act

- Federal government aimed to create sales tax conformity
- Remote sellers exceeding \$1 million in total U.S. gross receipts
- Multiple attempts, including 2013 and 2017
- Eventual decision made in *South Dakota v. Wayfair* in 2018

Uniformity Projects

- Joint resolution to address uniform taxation of digital goods and services
 - › Multistate Tax Commission (MTC), Federation of Tax Administrators (FTA) and Streamlined Sales Tax Governing Board
- MTC White Paper on Sales Taxation of Digital Products

Wayfair Tax Implications

- All states that impose a sales tax have implemented an economic nexus threshold
 - › Majority: \$100K in sales
 - › AL, MS: \$250K
 - › CA, NY, TX: \$500K
- Most states include gross sales to determine if exceeding thresholds
 - › Not AR, FL, MO (taxable sales only)
- Local jurisdictions either mirror state thresholds or create own
 - › AK – Does not have a state-imposed sales tax, however, several cities within impose one

Wayfair Tax Implications (cont.)

- Marketplace facilitators required to collect sales tax on behalf of sellers
- Intended for sales tax
 - › Other taxes including income/franchise taxes affected
- Revenues from state sales tax increased drastically

Post *Wayfair* – Where We Are Now

- Lack of uniformity
 - › Beginning effective dates range from 2018 (NY) to 1/1/23 (MO)
 - › Dollar and/or transaction thresholds
 - › Sourcing, filing frequencies, taxability varies
- Implementation of marketplace facilitator laws
 - › No standard definition of marketplace
 - › Marketplace facilitator often lists products/services for sale on behalf of sellers, collecting payment from purchaser
 - › Some states require facilitators to collect/remit tax

Post *Wayfair* – Where We Are Now (cont.)

- Other adopted standards aiming to increase sales tax revenue
 - › Affiliate, click-through, cookie nexus
 - › Notice and reporting requirements for remote sellers
 - › Changing sourcing from origin to destination based
 - › Economic nexus is not limited to state sales tax
- Increased need for technology, automation and outsourcing
 - › Maintaining sales and use tax (SUT) compliance
 - › Varying tax rates across jurisdictions
 - › ERP, tax automation software, exemption certificate management

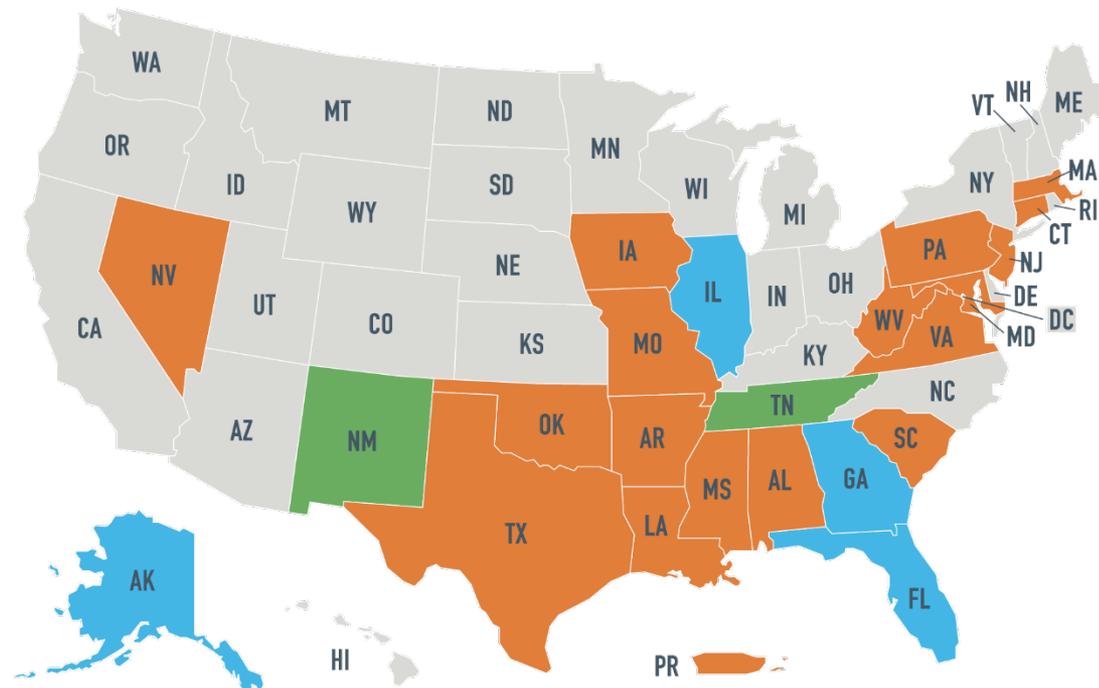
Sales Tax Trends

- Increase in sales tax holidays
 - › 98,910 sales tax holiday rule updates in the U.S.

States in 2023 with Sales Tax Holidays



Source: Avalara



Sales Tax Trends

- Gradual removal of nexus transaction threshold
 - › SD, LA, IN, WY
- Broadening of sales tax base
 - › Increase in taxable services and digital goods
 - › Retail delivery fee
- Lowering of income tax rates = Increase in sales tax rates
 - › Large focus of local rates

Sales Tax Breadth and Combined State and Average Local Rates

	Breadth	Rate
Kentucky	37.17%	6.00%
Georgia	29.09%	7.39%
Illinois	26.18%	8.84%
Indiana	37.96%	7.00%
Iowa	36.67%	6.93%
Missouri	28.66%	8.36%
North Carolina	35.23%	7.00%
Ohio	37.62%	7.24%
Tennessee	41.28%	9.55%
West Virginia	32.46%	6.57%
Virginia	23.61%	5.77%
National Mean	29.71%	7.14%
National Median	35.72%	7.02%

Note: Sales tax breadth data are for FY 2021. Rates shown are the combined state and average local sales tax rates as of July 1, 2023.

Sources: U.S. Census Bureau; state revenue departments; the late Prof. John Mikesell (sales tax breadth methodology); Tax Foundation research and calculations (rates and current breadth estimates).

A Changing Landscape – Taxes on Services and Digital Goods

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Current State Trends

- Cut/repeal individual income tax
 - › At least 20 states cut individual and/or corporate income tax rates since 2021
- Looking for new revenue streams
 - › Reduction of individual income tax rates has caused revenue to drop by hundreds of millions
- Tax is a popular route
 - › Expand the base
 - › Tax services
 - › Tax digital goods

Why Tax Services?

- Improves sales tax fairness
 - › Failure to tax services is unfair to people who prefer to buy goods
 - › Lawnmower vs. landscaping service
- Substantial immediate revenue potential
 - › Taxing services comprehensively could boost sales tax revenue approx. 25%-35%
- Long-term fiscal sustainability
 - › No loss of revenue if people change spending/purchasing habits

Sales & Use Tax (SUT) Changes - Kentucky

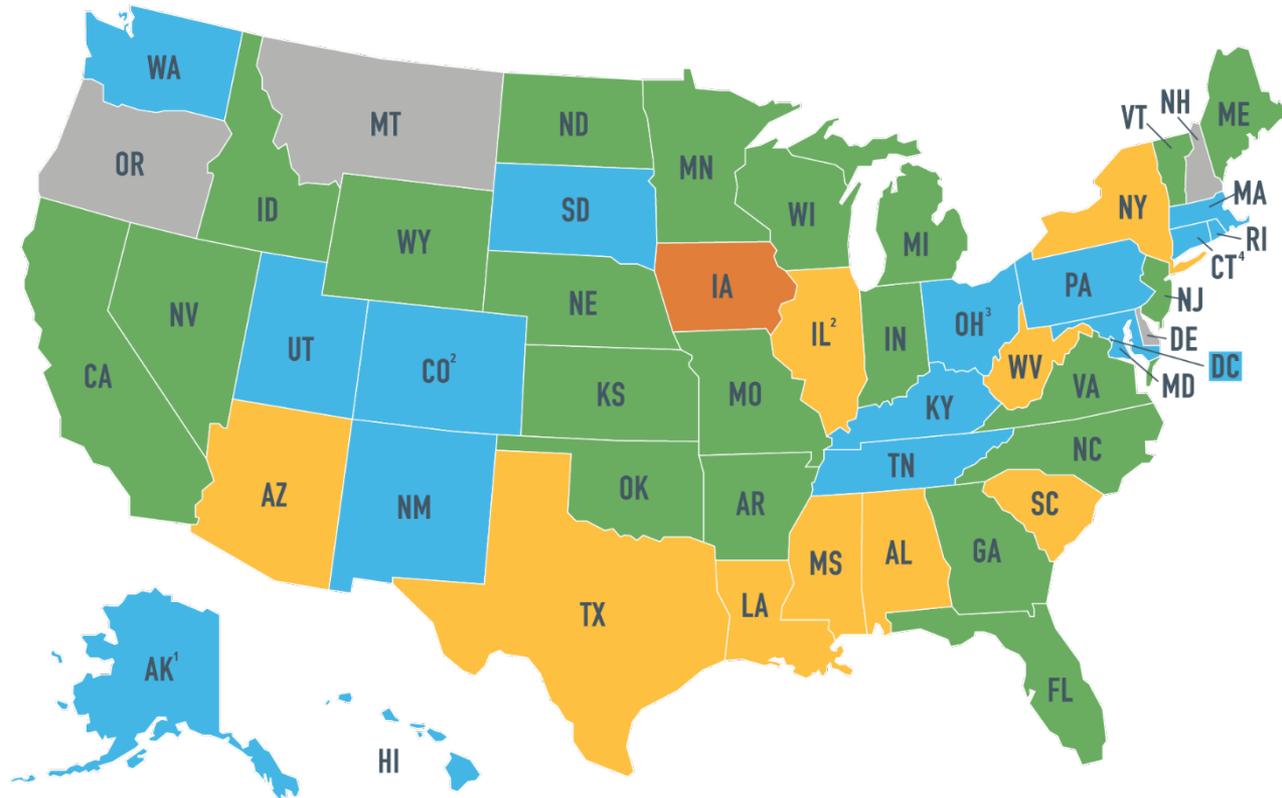
- 2018- H.B. 366
 - › Admission to sporting events/performances
 - › Pet care services
 - › Dry cleaning services
 - › Extended warranty services
 - › Landscaping services
 - › Installation and labor services
- H.B. 487
 - › Maintenance, repair and installation services not taxable for manufacturing process
- 2022- H.B. 8
 - › 30 Additional Categories
 - Prewritten computer software
 - Photography
 - Space rental services
- 2023- H.B. 360
 - › Clarified
 - Lobbying services
 - Laboratory services
 - › Removed
 - Marketing services

Digital Products

- Digital economy has led to large revenue base erosion
 - › Tax law focus on TPP
 - › Digital goods and services often not captured
- Attempts to recapture lost revenue in the form of sales tax base expansion or gross receipts taxes
- Non-uniform approaches to digital product classification

Tax on Digital Software Accessed Remotely (SaaS)

- Tax imposed but business purchases are exempt
- No tax imposed
- Tax imposed
- Tax asserted without clear authority
- No sales tax



¹AK – Data is based on local municipalities since Alaska does not have a state-wide sales tax

²CO/IL – State does not impose a tax, but tax may be imposed by some localities

³OH – Tax only applies to businesses

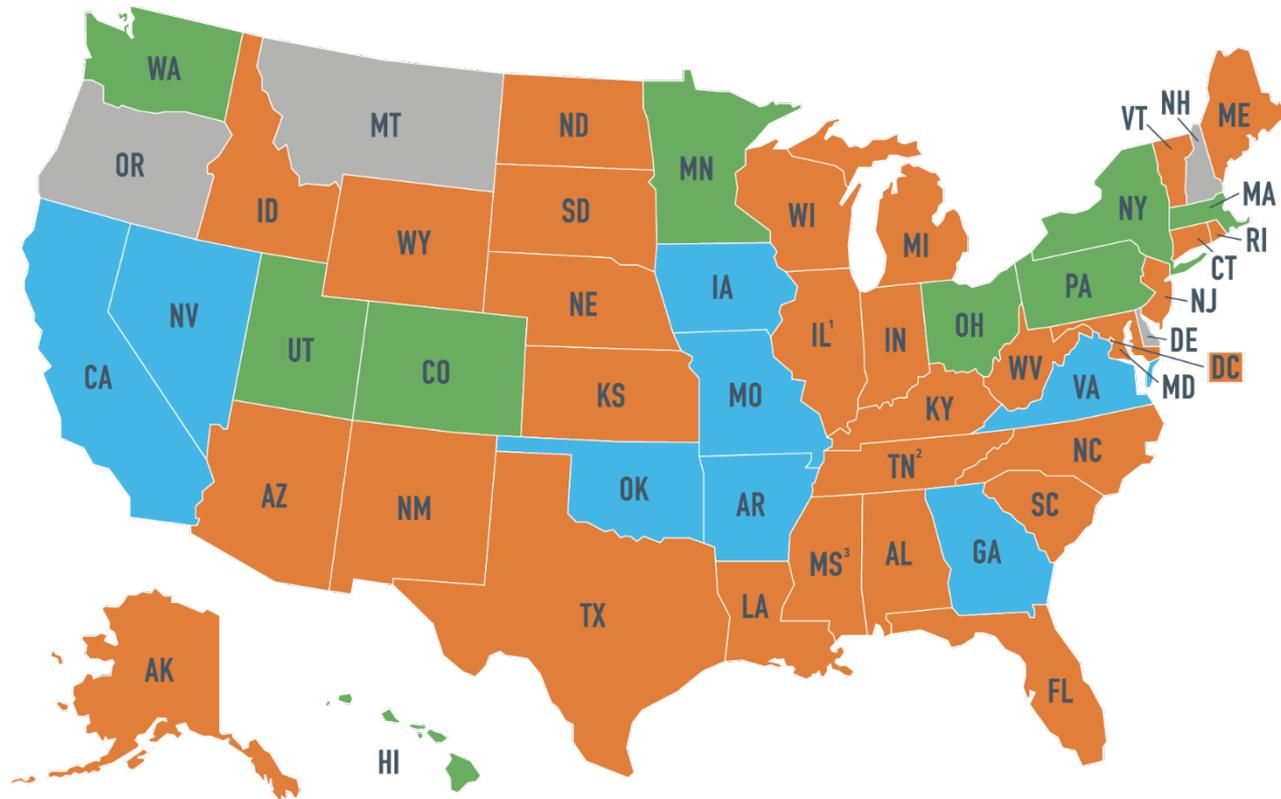
⁴CT – Electronically delivered software is taxed at a 1% rate for businesses

*Disclaimer: This information should be used for general guidance and not relied upon for compliance
Source: Council on State Taxation (COST)*



Multiple Points of Use (MPU) Apportionment with Digital B2B Purchases

- Allows MPU
- No MPU Needed
- No MPU
- No sales tax



¹IL – MPU allowed in Chicago
²TN – MPU is allowed for SaaS
³MS – MPU may be allowed on case-by-case basis

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 Source: Council on State Taxation (COST)*

Taxing Digital Advertising Services

- Ads on digital interfaces (software, websites, apps)
 - › Banner advertising
 - › Search engine advertising
 - › Interstitial advertising and comparable ad services
- Global annual gross revenue of \$100 million+ and deriving \$1 million+ from digital advertising in Maryland
- Currently under litigation

SUT Changes- Georgia

- Effective January 1, 2024
- Specified digital products - digital audio-visual works, digital audio works or digital books
- Other digital goods - the following items transferred electronically to an end user:
 - › Artwork
 - › Photographs
 - › Periodicals
 - › Newspapers
 - › Magazines
 - › Video or audio greeting cards
 - › Video games or electronic entertainment
- Digital code - a key, activation or enabling code that conveys a right to obtain one or more specified digital goods or other digital goods

Understanding Sales and Use Tax Audits

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States' Right to Audit Taxes They Administer

- Why am I being audited?
 - › Potential red flags
- Notification by letter or phone
- Legal entity being audited
- Audit period
- Tax type
- Records needed for the audit
- Audit start date

Audit Timing

- Start date of audit is in the notification letter
 - › Is the start date negotiable?
 - › Interest considerations
 - › Extending the audit period
 - › Waivers

Preparing for an Audit

- Start as early as possible
 - › File timely and accurate returns
 - › Keep up with tax law changes
 - › Build relationships with other internal departments
 - › Once notified of audit and prior to commencing
 - › Be sure information can be readily pulled for entire audit period
 - › Pull all documents auditor requested
 - › Review documents prior to giving them to auditor

What to Expect When the Audit Starts

- Auditor will request the following for the audit period:
 - › Copies of sales tax and/or use tax returns
 - › Support workpapers for returns to perform reconciliation
 - › Detailed general ledger and trial balance
 - › Potentially a plant tour (manufacturing)
 - › Invoices

Sampling in the Audit –

- Auditor will likely sample certain transactions
 - › Block Average
 - › Statistical
 - › Other
 - › Sample period should be representative of audit period
 - › Confirm with auditor which accounts included in the sample
 - › Be sure both parties in agreement prior to signing sample agreement

Keys for a Successful SUT Audit

- Know your business
 - › Acquisitions/disposals/mergers
- Gain credibility with auditor from the beginning
- Meet/communicate with auditor regularly
- Do not ignore auditor requests or deadlines
- Review prior audits
- Document key elements

Keys for a Successful SUT Audit

- Provide the auditor with audit timeline
- Only provide information requested by the auditor
- Review schedules provided by auditor to minimize liability
- Reconcile information
- Know which exemptions pertain to you
- Review for overpayments to offset liability
- Right to bring issues to audit supervisor if don't agree
- Can appeal audit liability if don't agree with assessment

Commonly Missed Items to Review for Overpayments

- Call Center
- Direct Marketing (Warehousing)
- Manufacturing
- Multiple Points of Use (MPU)
- Packaging
- Pollution Control
- Sale for Resale
- Utilities

How We Can Help — Beyond Compliance

- Audit Defense
 - › Assist at any point in the process
 - Can provide as much or as little assistance as taxpayer requests
 - Best if involved from beginning to manage auditor communication
 - › Necessary process changes
 - › Potential training/education opportunities

How We Can Help — Beyond Compliance

- Tax Refund Reviews
 - › Help identify sales/use tax overpayments to identify potential refund opportunities and exposure items
 - › Provide roadmap on refund claim process
 - › Work with you from inception to completion of the process
 - › Assist in the procurement of required documents
 - › Work with state auditors to process the refund claim

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