



Avalara

# SALES TAX CHANGES REPORT

# 2021

A TAX  
COMPLIANCE  
GUIDE FOR  
BUSINESSES

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## DISCLAIMER

Sales tax rates, rules, and regulations change frequently. Although we hope you'll find this information helpful, this report is for informational purposes only and does not provide legal or tax advice.

# INTRODUCTION

**It's no secret that sales tax is hard. Rates, rules, deadlines, and geographic differences create a web of complexity – and sales tax is always subject to change.**

While these changes can be mind-bending to keep track of, their adaptability and flexibility in times of economic uncertainty perhaps go underappreciated.

Europeans have used value-added tax (VAT) as an economic lever for years, as reduced rates and payment delays can provide instant cash flow. Americans followed their lead after COVID-19 ground the economy to a halt last spring, offering filing or payment extensions and penalty waivers. Now, states are striving to balance the need for tax revenue with the need to help taxpayers. The uncertainty brought on by the pandemic reveals just how reliant we are on indirect taxes and how their changes can have meaningful impact for local economies.

Our fifth annual sales tax changes report highlights some of this year's key legislative developments and explores emerging trends. With our exceptional expertise and proven leadership in the domestic and global tax compliance ecosystem, Avalara is here to help ensure sales tax doesn't stand in the way of your opportunity.

So, is there really anything left to say to 2020 other than *good riddance*?

COVID-19 defined 2020 and will strongly influence 2021. In a few short months, the pandemic drastically altered how we learn, shop, socialize, travel, and work, and that's had an enormous impact on the economy. As of August 31, 2020, nearly **100,000 businesses** in the United States, including approximately 20,000 restaurants, closed their doors permanently; tens of thousands more are struggling to survive despite periodic shutdowns and capacity restrictions. Millions of K-12 and college students are attending school virtually and everything from concerts to conferences moved online.

Though far from ideal, it's not *all* bad. When COVID-19 reduced demand for core products, entrepreneurial manufacturers pivoted to produce critical personal protective equipment (PPE). Millions of Americans are working, productively, from the relative safety of home. Ecommerce is booming, and more consumers have discovered how easy it is to buy online and pick up in store. Takeout is thriving, and thanks to relaxed alcohol laws, consumers can purchase beer, wine, and cocktails to go. With people desperate for a change of scenery, short-term rentals are rebounding. In short, many businesses are finding ways to adapt and succeed in the new reality.

But you know this. What you may not know is how COVID-19 has affected or will affect sales and use tax and overall tax compliance.

**General fund revenues in most states declined** during the fiscal year that ended June 30, 2020, as did revenue from other taxes and fees. The longer the crisis lasts, the harder it will be for states, cities, and counties to balance their books; COVID-19 will likely impact budgets



**So, is there really anything left to say to 2020 other than good riddance?**



**Number of businesses marked closed on Yelp that were open March 1:**

April 2020

**36,718**

June 2020

**75,020**

August 2020

**97,966**

for years to come. Thus, 2021 could bring tax relief measures as well as some new taxes.

If there's a lesson to be learned from 2020, it's that we don't know what the future will bring.


That said, we're not totally in the dark. We know, for example, that:

- Governments worldwide are developing new tax policies in response to COVID-19
- The pandemic could have a lasting impact on ecommerce and other industries
- There is certainly uncertainty ahead

For our 2021 report, we've made it easy to find industry-specific compliance information related to ecommerce, retail, services, manufacturing, and software.

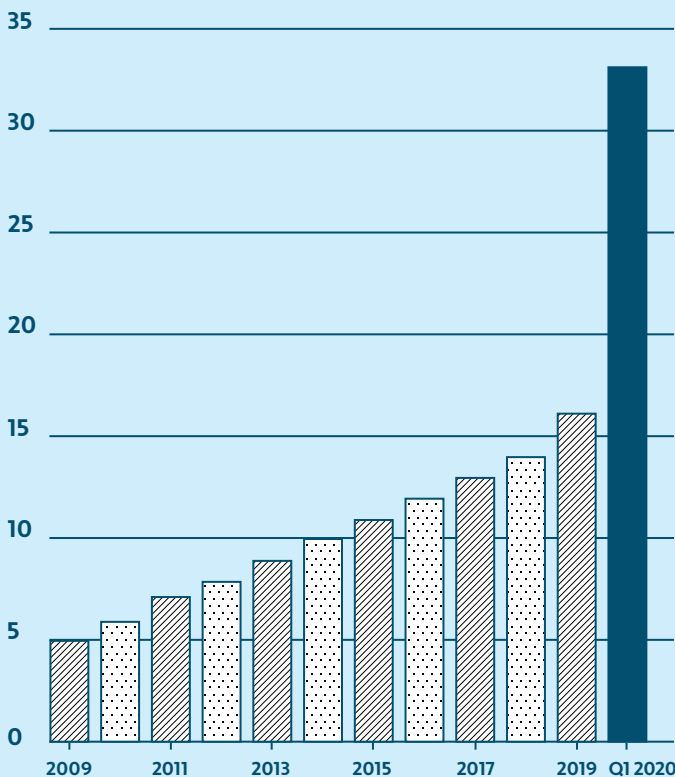
Alright, let's do this.


# What the numbers tell us

 Nearly **\$1 out of every \$5** spent during Q3 came from orders placed online


10 years' worth of U.S. ecommerce adoption was **compressed into three months** at the start of 2020

U.S. ECOMMERCE PENETRATION, %



 63% of consumers are **buying more online** to avoid stores

 21% rise in **global ecommerce sales** during the first half of 2020

 93% of online consumers have **shopped on a marketplace**

B2B marketplace sales worldwide **could reach \$3.6 trillion by 2024**, up from \$680 billion in 2018



Global B2C marketplace sales could reach **\$3.5 trillion annually** in 2024, up from \$1.1 trillion in 2018



# COVID-19'S EFFECT ON SALES TAX

# States that need tax revenue know where to get it

Though some states are recovering better than expected from COVID-19's gut punch, the news isn't all rosy. In early November, the [Center on Budget and Policy Priorities](#) reported that "state revenues have declined precipitously and costs are rising sharply, with many businesses closed or operating at reduced hours and millions of people recently unemployed."

It's too soon to know the full extent of the damage or the recovery; much will depend on the severity and duration of the pandemic and what federal aid, if any, is provided. Many states started 2020 with healthy reserves, but 2021 is likely to be different.

States won't want to add to the economic burdens of their taxpayers. However, they'll need all the tax revenue they can get. In order to find it, they may try to:

## 1. BROADEN TAX TO EXEMPT GOODS AND SERVICES

The Tax Foundation recommends [broadening sales tax bases](#) rather than increasing taxes. Some of the products and services that have remained in high demand throughout the pandemic, such as groceries and digital goods, are exempt in numerous states. A broader tax base may make for a less regressive tax policy, but can be a hard sell. Wyoming, which is in dire need of additional revenue, [put a tax on groceries on the table](#); it was voted down upon introduction.



**Estimated drops in general fund tax revenue for 2021 due to COVID-19:**

Hawaii

-23%

Massachusetts

-9 to -31%

Nevada

-26%



***A broader tax base may make for a less regressive tax policy, but can be a hard sell.***



Maryland, Nebraska, New York, and Washington, D.C., **all proposed new taxes on digital advertising services** in 2020, though only Maryland's measures made it to the governor's desk. He vetoed what he called "misguided bills," but the Maryland General Assembly may vote to override the veto when they reconvene in 2021. Expect other states to watch these cases with interest. Digital advertising is widespread, so taxing these services could generate much-needed revenue.

## 2. UNCOVER UNREGISTERED REMOTE SELLERS

**More than 43 states, the District of Columbia, and some local governments in Alaska now tax remote sales via economic nexus,** meaning the connection that creates a tax obligation (nexus) for a business is based on sales or transaction volume rather than physical presence – though physical presence in a state continues to be a nexus trigger.

Economic nexus laws have dramatically altered the tax compliance landscape since the first laws took effect July 1, 2018. To give businesses time to adjust, states have been slow to bring down the hammer of enforcement. Those days are over: **Revenue departments will be under pressure to increase audits as soon as they can.**

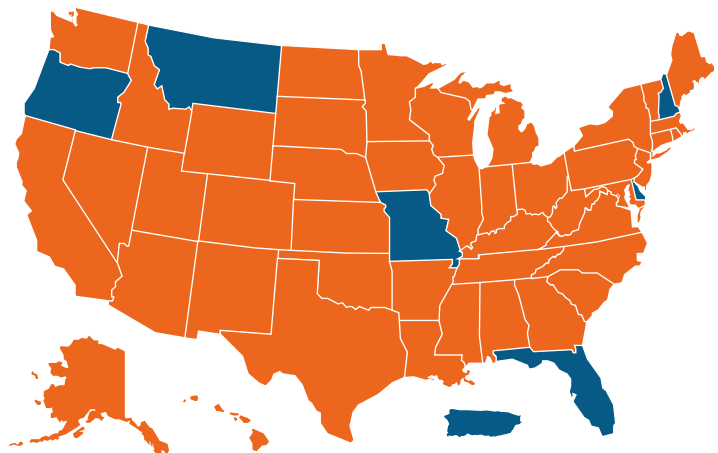


### "Advertising services" definition:

The planning, creating, placing, or display of advertising in newspapers, magazines, billboards, broadcasting, and other media, including, without limitation, the providing of concept, writing, graphic design, mechanical art, photography, and production supervision.

### ECONOMIC NEXUS LAWS BY STATE

 States with economic nexus laws



With the unofficial grace period over and the need for revenue acute, tax authorities are focusing their attention on remote sales tax compliance. In fact, according to Robert Peters of financial consulting firm Duff & Phelps, “[sales tax audit traffic has increased significantly](#)” since the [South Dakota v. Wayfair, Inc. U.S. Supreme Court decision](#) and the pandemic. Some states are using artificial intelligence and data mining tools to uncover noncompliant businesses; others are taking a more old-school approach, simply shopping online to see whether tax is charged. Many states that eased up on enforcement efforts due to COVID-19 will be looking to [accelerate audits](#) as soon as they can.

Then there’s Kansas, which began enforcing economic nexus October 1, 2019. It’s reportedly collected some \$5 million in remote sales and use tax since then, but the tax authorities know there are unregistered sellers making sales in the state. In October 2020, Kansas Revenue Secretary Mark Burghart said the department intends to [go after noncompliant remote sellers](#), starting with large sellers before moving on to small sellers.

Kansas is unusual in that it provides no exception for small sellers: One sale in the state can create nexus. But experts agree, economic nexus compliance is “fertile territory for tax auditors” in all states. In fact, both Kentucky and South Dakota were looking to [hire more auditors](#) in early 2020 to improve tax collections.

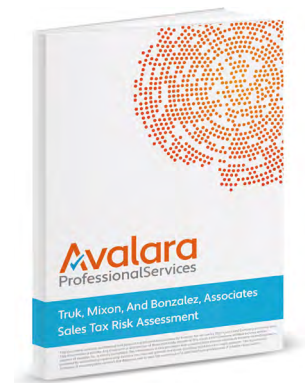
Expect states to undertake “more aggressive auditing” as soon as the pandemic allows. Negative audit findings coupled with penalties and interest can lead to enormous financial burdens for businesses. Avalara’s [sales tax risk assessment](#) can help businesses identify their high-risk states.

### 3. MOVE ON MARKETPLACES AND MARKETPLACE SELLERS

Florida, Kansas, and Missouri may finally require marketplace facilitators to collect and remit tax on behalf of third-party sellers as most other states do. All three states could use that additional tax revenue.



*Expect states to undertake “more aggressive auditing” as soon as the pandemic allows.*



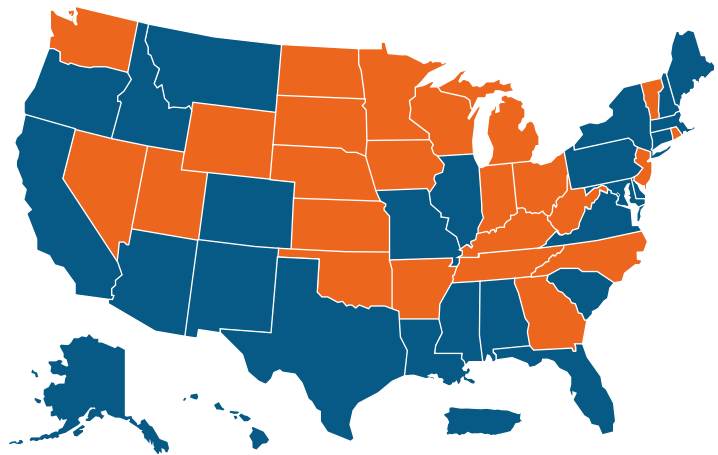
[Avalara Sales Tax Risk Assessment](#)

**Missouri lawmakers introduced legislation** in November that would require out-of-state sellers to collect and remit Missouri sales tax and make marketplace facilitators responsible for collecting and remitting tax on third-party sales. It would also allow Missouri to participate in the **Streamlined Sales and Use Tax Agreement** as a nonmember, which would reduce the burden of compliance for remote sellers. If enacted as written, the collection requirement will take effect January 1, 2022, and Missouri could become the first nonmember state to offer SST certified service provider (CSP) services.

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## STREAMLINED SALES TAX BY STATE

 SST member states



Kansas lawmakers introduced several marketplace facilitator bills in early 2020, but all died in committee. The situation is similar in Florida: bills that would require remote sellers and marketplace facilitators to collect and remit sales tax stalled or were killed. The issue is likely to resurface in both states once legislatures reconvene in 2021.

Marketplaces already collect and remit tax for sellers in California, but that doesn't mean marketplace sellers are entirely off the hook for sales tax. For more than a year, the **California Department of Tax and Fee Administration (CDTFA) has been quietly sending notices to Fulfillment by Amazon (FBA) sellers**, holding them liable for past sales tax. The CDTFA claims these marketplace sellers had a physical

presence in the state because they had inventory stored for sale in a marketplace facilitator’s warehouse or fulfillment center.

A trade association for small online sellers is suing the CDTFA for “crushing thousands of small business owners.” It’s a case to watch in 2021. If California is successful, other states with marketplace fulfillment centers could follow suit.

Indeed, Washington state has also found marketplace sellers liable for past sales tax based on their inventory in the state, even though **ownership of the inventory was transferred digitally** by the facilitator, and the seller didn’t actually ship products into the state.

Sales tax policies tend to function like dominoes: What works in one state is often adopted by other states. If California and Washington successfully increase tax collections with these sorts of moves, marketplace sellers that have had inventory in other states for years could receive tax notices in 2021 and beyond.

## 4. CRACK DOWN ON CONSUMER USE TAX

Vermont recently changed how individuals can **report consumer use tax** on their income tax returns: Consumers can report the exact amount of use tax liability or report a percentage of their adjusted gross income.

Mismanaging consumer use tax commonly ranks in the top five costliest compliance mistakes made by companies. Inventory transfers, promotional giveaways, and withdrawing inventory for internal use are among the **most common errors companies make with respect to sales and use tax** – and auditors know it.

States in need of revenue often turn to tried-and-true methods to increase collections, so 2021 could bring increased scrutiny of **consumer use tax compliance**.



*Inventory transfers, promotional giveaways, and withdrawing inventory for internal use are among the most common errors companies make ... and auditors know it.*



**In Vermont, the maximum use tax owed in a year based on income is \$150.**

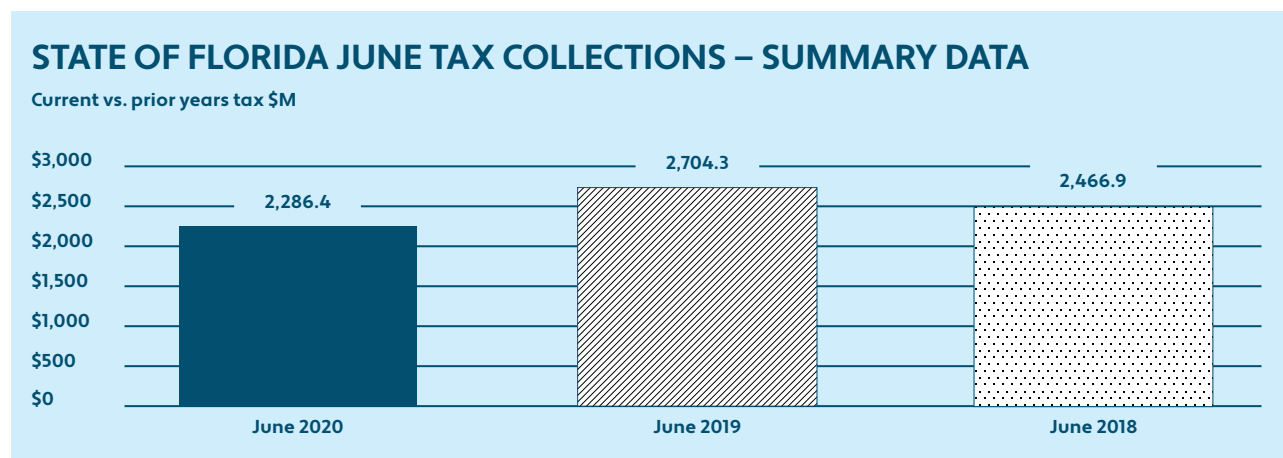
## 5. TAX COVID-19 SURCHARGES

Some retailers have started applying COVID-19 surcharges to help cover costs incurred because of the pandemic, such as purchases of PPE or increased handling fees. These fees may be subject to tax in some states, now or in the future.

South Carolina has determined the [COVID-19 surcharges](#) charged by some retailers to help cover pandemic-related costs are subject to the state's sales tax, as are handling fees and takeout charges. Since these fees are relatively new, expect other states to start addressing their taxability.

## 6. KEEP UP WITH THE JONESES: FLORIDA AND MISSOURI COULD FINALLY ADOPT ECONOMIC NEXUS

In 2020, Florida has seen [sales and use tax collections drop year over year](#), in part because the state doesn't tax remote sales, and because in-person sales and tourism have decreased due to COVID-19. In June 2020, the governor vetoed \$1 billion in spending (approved before the pandemic) and called for additional cuts to be made. Will COVID-19 provide the motivation the Sunshine State needs to make economic nexus happen?



Sales and use tax collections are stronger in [Missouri](#), the only other state that has a general sales tax but doesn't tax remote sales. Yet as they have in the past, lawmakers in the Show-Me State will try to get an economic nexus bill on the governor's desk as soon as possible. [House Bill 2, introduced in November 2020, could be the one that gets signed.](#)

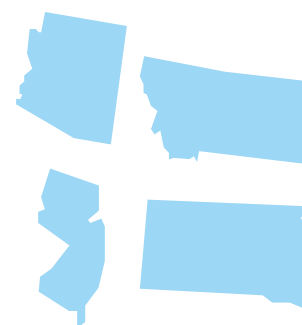
## 7. MORE STATES WILL LIKELY LEGALIZE AND TAX MARIJUANA

When many retail stores were forced to close or limit access due to COVID-19, medical and even recreational marijuana retailers were deemed [essential enough to remain open in some states](#). And the pandemic is accelerating movements to allow marijuana products to be sold online and delivered or prepared for curbside pickup.

[Washington state temporarily expanded curbside sales](#) beyond qualified medical patients so marijuana retailers could comply with social distancing rules. The prohibition on online sales of retail marijuana and marijuana products has been temporarily suspended in Colorado, where [delivery of recreational pot](#) will be permitted starting in 2021. [Massachusetts, Michigan, Illinois, and Oregon also now allow online sales of marijuana](#), and California has allowed retailers to [deliver recreational marijuana to consumers](#) since January 2019.

Internet sales of marijuana continue to be hindered by the fact that many credit card companies won't process sales of [Schedule 1 substances](#). The more commonplace online sales become, the greater the pressure for that to change – and the trend toward legitimization and legalization seems clear. In November 2020, residents of [four more states](#) voted in favor of legalizing marijuana, including South Dakota, the first state to legalize both medical and recreational marijuana simultaneously.

But legitimacy comes at a price. In these states, as in others, retailers must comply with all permitting and tax laws. Indeed, one of the reasons states are willing to legalize marijuana is so they can tax



**On November 3, 2020, residents of Arizona, Montana, New Jersey, and South Dakota voted to allow the possession, use, and retail sale of marijuana.**



### “Schedule 1” definition:

Schedule I drugs, substances, or chemicals are defined as drugs with no currently accepted medical use and a high potential for abuse.

those sales. Expect to see more states move to legalize – and tax – pot in the coming year.

## 8. BLAZE FORTH WITH CIGARETTE, TOBACCO, AND VAPING TAXES

Voters in Colorado approved [higher taxes on cigarettes](#) and tobacco products in November 2020. Oregon voters did the same, supporting [higher taxes on tobacco products](#) and e-cigarettes. And come January 1, 2021, [Georgia will tax vapor products](#).

In the coming months, other states could look to increase cigarette taxes and increase or implement taxes on vapor products.

## 9. EYE NEW TAX POTENTIAL FROM REMOTE EMPLOYEES

Employees at many companies, from Amazon to Avalara, have been working remotely since March 2020. As of this writing, Amazon has extended remote work for office employees to June 2021, Google until the fall of 2021, Starbucks until October 2021. And Facebook? Much of its workforce could be remote for the next decade.

There are many good reasons to celebrate extended remote work policies, not least of which is the lack of a commute. However, having employees work remotely can have tax implications.

At the start of the pandemic, several states were quick to say they [wouldn't enforce certain nexus provisions on employees](#) temporarily working from home in a state because of COVID-19. These include Indiana, Maryland, Massachusetts, Minnesota, and Mississippi. However, that goodwill is unlikely to last forever.

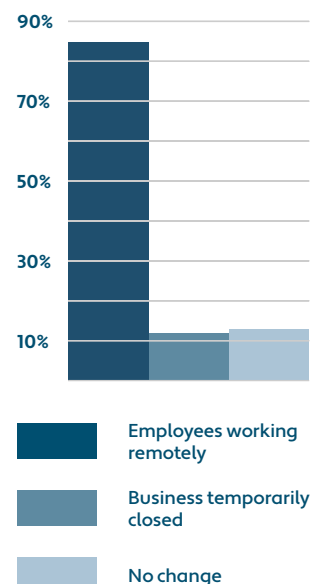


**Nearly 70% of Coloradans voted for higher taxes on cigarettes.**

With these changes, the minimum price for a 20-pack of cigarettes will be \$7 as of January 1, 2021, and \$7.50 as of July 1, 2024.



**How is COVID-19 affecting your business? An informal survey by Avalara:**



***“At the start of the pandemic, several states were quick to say they wouldn’t enforce certain nexus provisions on employees temporarily working from home in a state because of COVID-19 ... However, that goodwill is unlikely to last forever.”***

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The longer people work remotely, either from home or elsewhere ([Barbados or the Canary Islands](#), anyone?), the more likely they are to create new franchise, income, gross receipts, payroll, or sales and use tax liability for themselves or their companies. After all, [physical presence in a state typically triggers nexus](#).

[Congress may intervene](#) to lessen the tax burden for businesses and employees. Several bills were introduced in 2020, including the [Remote and Mobile Worker Relief Act of 2020](#) and the [Multi-State Worker Tax Fairness Act of 2020](#), but Congress got sidetracked. That could change in 2021.

## 10. STAY HOME: TAXES ON SHORT-TERM RENTALS GENERATE MUCH-NEEDED REVENUE

Just about everyone is tired of being at home *all the time*. Since the pandemic prevents us from embarking on far-flung adventures, a short-term rental the next state or town over just might do when a change of scenery is needed.

Once able to resume operations, short-term rentals have proven to be highly resilient during these challenging times. [State and local governments will likely expect them](#) to pay all applicable taxes and comply with all applicable rules and regulations.

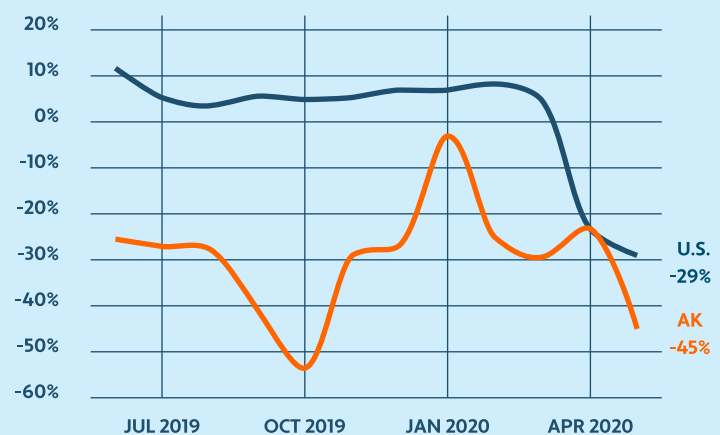


# Stressed cities will tax what they can

Sales tax is often discussed at the state level, but in many states, local sales taxes play an integral part in funding local schools, services, and transportation.

Local governments have the authority to levy and administer local sales tax in home rule states. That's the case in Alaska, where the pandemic has caused [an impressive deficit](#). More than [30 cities and boroughs](#) in the Last Frontier already require certain out-of-state sellers to collect and remit sales tax under economic nexus regulations. As of this writing, six more cities are working to implement a remote sales tax. To fill budgets cratered by plunging oil prices, expect others to follow in 2021. Alaska has no income tax or statewide sales tax.

## CHANGE IN MONTHLY REVENUE VS. PREVIOUS YEAR (3-MONTH AVERAGE)



In need of money, many localities in [Missouri](#) increased local sales and use tax rates effective October 1, 2020. Local rates in [Washington state](#) and [Illinois](#) will jump January 1, 2021. Voters in Denver agreed to raise sales and use tax by 0.5% on January 1, 2021, to generate revenue to [eliminate greenhouse gas emissions](#) and [provide shelter for the homeless](#).

Several cities around the country, including Indianapolis, Indiana, and New Boston, Texas, are **fighting to tax streaming services**. They claim streaming service providers should pay to use internet equipment in the public right-of-way. There's a chance other cities will follow suit in 2021. With more Americans cutting the cable cord to stream content, local governments reliant on cable taxes need new sources of revenue.

Chicago has applied its amusement tax to streaming services for some time, and Mayor Lori Lightfoot's 2021 budget plan seeks to **increase the tax on computer leases of cloud software** and cloud infrastructure in fiscal year 2021. Other cities in need of revenue could look to do the same.

In Ohio, a provision **allowing cities to collect income taxes from remote workers** no longer commuting into the city for work was on track to expire December 1, 2020. Unless renewed, some cities could experience a significant drop in income tax collections. This could be powerful motivation to increase other tax collections.



### Netflix added

# 25 million

subscribers during the first six months of 2020



### Chicago 2021 Budget Proposal:

*"First is a 1.75 percentage point increase to the Personal Property Lease Tax applied to non-possessory computer leases of cloud software and cloud infrastructure that brings this tax in alignment with the tax imposed on all other lease, rental or use of rented, personal property currently taxed at 9.0 percent."*

# The future of tax relief is uncertain

Some states ended up beating revenue expectations (adjusted for COVID-19) in 2020, but the future looks less promising. Overall tax revenue may have been more resilient than anticipated when the pandemic first shuttered businesses last spring, but states have seen large drops in collected hotel taxes, inspection fees, withholding taxes, and other taxes.

There are a lot of unknowns: Will there be a viable vaccine? Will Congress pass another stimulus package? Will more businesses close and more people become unemployed? These and other factors will affect future tax relief.

Still, non-store retail, which includes ecommerce, increased **29.1% year over year** in October 2020. Just as ecommerce has been a lifeline for consumers during the pandemic, the revenue it generates is allowing certain states to give a little something back to taxpayers.

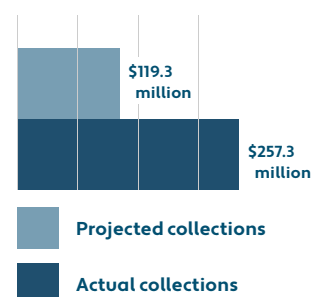
For example, to offset higher than expected remote sales and use tax collections, as required by law, Wisconsin is lowering tax rates for the bottom two individual income tax brackets. According to the [Wisconsin Department of Revenue](#), actual sales and use tax collections from remote sellers and marketplace providers from October 1, 2019, through September 30, 2020, were \$257.3 million, \$138 million above projections.



**States have seen large drops in collected hotel taxes, inspection fees, withholding taxes, and other taxes.**



**Wisconsin remote sales and use tax collections from Oct. 1, 2019, through Sep. 30, 2020, exceeded projections:**



## SALES TAX HOLIDAYS ENCOURAGE CONSUMPTION BY TEMPORARILY ELIMINATING SALES TAX

Tax relief comes in many forms. In October 2020, the Louisiana Legislature unanimously approved a one-time state sales tax holiday. During the weekend before Thanksgiving, the first \$2,500 of the cost of tangible personal property purchased for individual use, with the exception of vehicles, was exempt from state sales tax. The goal? “**Provide relief for recovery** as a result of Hurricane Laura and the COVID-19 pandemic.”

New Mexico’s **Small Business Saturday sales tax holiday**, held the weekend after Thanksgiving each year through 2024, was created to help small businesses compete with large competitors. In a similar vein, New York lawmakers are considering a **sales tax holiday for restaurant food**.

## TAX CUTS FOR ESSENTIALS

**New Orleans recently cut the local sales tax rate for diapers and feminine hygiene products**, although a portion of the local tax and the state sales tax still apply. The New Orleans City Council spoke of lowering the cost of these essential items “during the pandemic-induced economic downturn,” though in fact, the council first proposed the exemption in 2019, before COVID-19 hit the U.S.

During its August sales tax holiday, Florida **extended the temporary sales tax exemption** to include cloth and disposable face masks. Last spring, **Puerto Rico temporarily exempted a variety of essential items**, including face masks, hand sanitizer, and vinyl gloves. These sorts of exemptions could resurface in 2021.



**To help small businesses compete with their larger counterparts during the holidays, New Mexico offered a one-day sales tax holiday for small businesses, held on the Saturday after Thanksgiving through 2024.**

## DIFFERENT DISASTERS SPARK DIFFERENT TAX RELIEF MEASURES

Much of the [tax relief provided by states and cities](#) during the early stages of the pandemic has expired. However, the longer the pandemic lasts, the more likely states are to come up with new relief efforts.

The California Department of Tax and Fee Administration is offering an [interest-free payment plan for small businesses](#) with less than \$5 million in annual taxable sales. The relief is available for up to \$50,000 in sales and use tax due on returns with original due dates between March 1, 2020, and July 31, 2020. Liability must be paid in full by July 31, 2021.

California is also one of several states providing [tax relief to victims of a natural disaster](#), in its case, fire. Colorado, Louisiana, Texas, and Washington are among the other states allowing adversely affected taxpayers more time to file.



**In California, Louisiana, and Texas, taxpayers affected by severe weather or fires may be eligible for an extension to file and pay taxes due.**

## GLOBAL VAT RELIEF

The disruptive force of COVID-19 stretches well beyond the U.S. Clearly. Here are some trends to watch out for in 2021 in other parts of the world.

Since value-added tax (VAT), which is applied in over 170 countries, can be adjusted overnight to immediately boost consumer spending, it's been the go-to for tax relief in most countries during the pandemic. Relief will likely continue as long as it's considered effective.

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***“Since VAT ... can be adjusted overnight to immediately boost consumer spending, it's been the go-to for tax relief in most countries during the pandemic.”***

The European Union has [prolonged the temporary waiver](#) of customs duties and VAT on imports of medical devices and protective equipment through April 2021. It's also proposing to grant VAT relief to sales of coronavirus vaccines and testing kits to hospitals and medical practitioners. And several countries have cut the tax on face masks, most recently [Greece](#) and [Spain](#), though Britain's temporary zero rate for face coverings and other PPE [expired](#) October 31, 2020.

Many countries have temporarily slashed or altogether cut VAT on catering, food, hotel services, passenger transport, and cultural and sports activities. Many are also delaying VAT payments and returns deadlines well into 2021. Avalara tracks these changes and more in [World turns to VAT cuts on coronavirus COVID-19 threat](#) and [COVID-19 VAT rate cuts](#).

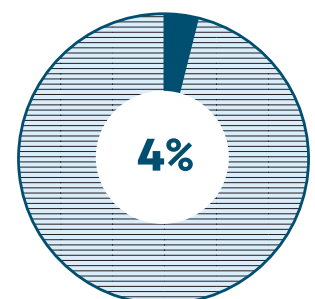
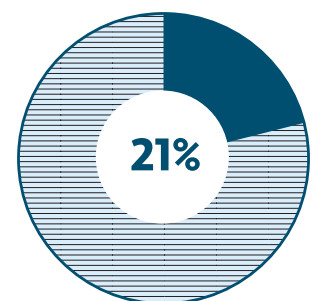


### The European Commission on establishing more detailed customs tariff codes on imported masks:

*"Protective face masks are the most imported of these goods by far, accounting for almost 50% in value of all imported goods under the Decision."*



### Spain sales tax rate change on face masks:



# INDUSTRY IMPACTS

No matter your industry, the events of 2020 likely impacted you in a major way. In this section we explore new and emerging sales tax and compliance developments in the following industries:

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# Ecommerce is more important than ever

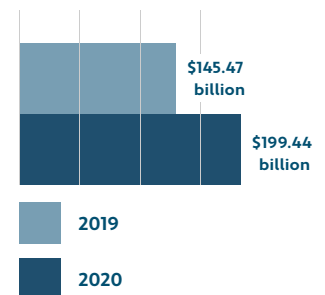
**Retail spend has been steadily moving online for years** – a trend COVID-19 forced to accelerate across every region, demographic, and industry. During the second quarter of 2020, when U.S. retail overall took a hit because of social distancing measures, ecommerce sales increased by almost 32%. In the third quarter, consumers spent \$199.44 billion online with U.S. retailers, **up 37.1% year over year**. In other words, **nearly \$1 in every \$5 spent** during the third quarter came from orders placed online.

This explosion of online sales can have sales tax implications because of the Supreme Court’s decision in *South Dakota v. Wayfair, Inc.* and the subsequent enactment of state economic nexus laws. Retailers whose ecommerce sales have grown significantly since the start of the pandemic are at risk of establishing economic nexus and an obligation to collect and remit sales tax in any or all of the 43 states with economic nexus laws, plus D.C. and parts of Alaska.

As COVID-19 continues to affect communities throughout the U.S. and world, ecommerce will continue to be the go-to model for both consumers and businesses in the foreseeable future. Foot traffic is trending down, with **62% of consumers shopping online** more now than before the pandemic. Economic nexus should therefore be top of mind for retailers selling online.

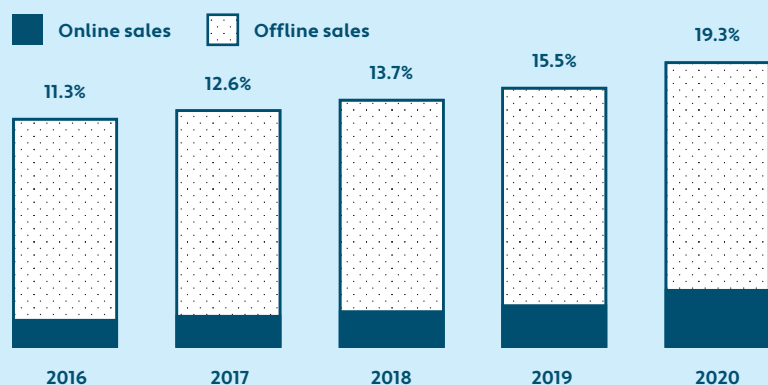


## Year-over-year Q3 ecommerce sales:



## FIVE YEARS OF U.S. Q3 ECOMMERCE PENETRATION

Online and offline sales as a % of total retail spend (excluding sales of items not normally purchased online)





Many internet retailers are making direct and marketplace sales while also growing into global markets. These and other developments can affect sales tax, as well as customs duty and import tax compliance.

## GROWTH IN GLOBAL ECOMMERCE STRAINS SUPPLY CHAINS

The pandemic is also spurring a spike in global ecommerce. With in-person shopping and travel dissuaded, consumers are expanding horizons by exploring international vendors. [Amazon's global sales](#) alone could hit \$416.48 billion in 2020 according to Business Insider – \$12 billion more than its pre-pandemic estimates.

Yet while COVID-19 may accelerate global ecommerce, it's also revealed its Achilles' heel: strained supply chains. Back in February, Gartner voiced concerns about the [pandemic's potential impact](#) on consumers, labor, logistics, materials, and sourcing. It was prophetic. [COVID-19 led to factory closures](#), which reduced output, which reduced supplies of certain goods. Port closures held shipments hostage in deepwater ports and caused traffic jams at customs. Volatile tariff wars created additional uncertainties. You remember.

The situation has improved since early spring – hand sanitizer and toilet paper are generally back on the shelves. However, ecommerce merchants are still encountering shipping delays during periods of peak demand. If customs duty and import taxes aren't handled properly, international shipments may experience additional delays.

For a global shipment to reach its destination without delay, all applicable customs duties, import taxes, and shipping costs must be paid. Labeling all contents of a shipment with the appropriate [Harmonized Tariff Schedule code](#) (HTS code, or HS code) allows customs officials to track the flow of goods and ensure the correct international tax has been paid.

Since there's a code for every product under the sun, manually assigning each code is incredibly burdensome. [Item classification](#)



HTS codes cover all kinds of products:



Badminton racket  
9506.59.40



Suit jacket, mens, wool  
6103.10.10



Hammer under 1.5kg  
8205.20.30



Candle, tapered  
3406.00.00

**software** enables retailers to efficiently identify HS codes for each product and automatically determine customs duty and import tax rates. This helps shipments flow smoothly across borders without getting held up at customs.

With **85% of the world's purchasing power** located outside of the U.S., and global ecommerce companies growing 1.3 times faster than their domestic counterparts, retailers have a compelling reason to sell across international borders. And since 95% of consumers expect all shipping fees and taxes to be visible at checkout, **automating cross-border tax compliance** makes good cents.

## BREXIT CREATES NEW U.K. VAT, CUSTOMS, AND TARIFF OBLIGATIONS FOR BUSINESSES

Supply chains and tax compliance will experience new challenges due to Brexit.

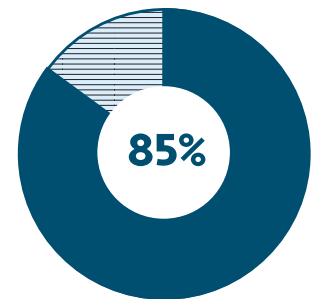
As of January 1, 2021, the U.K.'s departure from the EU Customs Union and VAT Regime dramatically affects customs, tariff, and VAT compliance for hundreds of thousands of businesses in the EU and U.K. Sellers based in the U.S. with customers in the U.K. and the EU will also be affected, especially those accustomed to shipping into or out of warehouses and fulfillment centers in Britain.

Most U.S. sellers and marketplaces will have to be U.K. VAT registered or their goods will be blocked at the U.K. customs border. Her Majesty's Revenue & Customs (HMRC) is imposing new **ecommerce VAT registration and customs obligations** on any non-U.K. merchant selling goods to U.K. consumers not exceeding £135. See **Brexit EU VAT & customs options for UK ecommerce sellers** for more details.

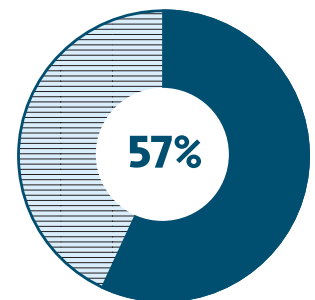
This is a **Wayfair moment** for Britain (aka, a big deal), and businesses are understandably concerned about the transition. Learn about the key changes and how Avalara can help you keep goods flowing while reducing your tax burden in **Brexit: how to manage the VAT and customs risk** and **Brexit, where are we now?**



**Limiting your business to domestic sales narrows your slice of the pie:**



85% of the world's purchasing power is outside the United States



57% of global shoppers make purchases from retailers in other countries

## WITH INCREASED MARKETPLACE SALES COME NEW TAX OBLIGATIONS

Global sales are a key area of growth for marketplaces as well. Long at the top of American ecommerce, marketplace giant [Amazon is focusing on growing international sales](#) – and with more than 639 fulfillment centers on foreign soil, it’s broadening the reach of its fulfillment services. It’s also working to [ensure a smooth Brexit transition](#) for third-party sellers doing business in Britain and the EU.

Business-to-business (B2B) marketplace transactions are another key area of growth, both in the U.S. and abroad. Valued at \$680 billion in 2018, B2B marketplace sales could reach [\\$3.6 trillion](#) by 2024; that surpasses the impressive growth of business-to-consumer (B2C) marketplaces, which are expected to jump from \$1.1 trillion in 2018 to \$3.5 trillion in 2024.

Marketplace transactions bring unique sales tax challenges for facilitators and sellers:

### REQUIREMENTS FOR MARKETPLACE FACILITATORS

As noted, most states in the U.S. generally require marketplace facilitators to collect, remit, and report tax on third-party sales. Along with that, marketplaces may have certain reporting requirements to their sellers. For example, [Washington state requires marketplace facilitators](#) to provide each marketplace seller with access to information regarding gross Washington sales made on their behalf during the previous month.

The role of marketplace facilitators is a bit different in the EU, and it’s changing.

### [Sweeping reforms to VAT obligations for B2C ecommerce sellers and marketplaces](#)

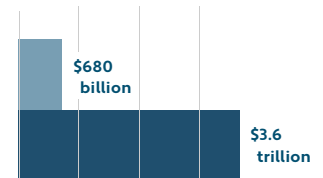
are set to take effect July 1, 2021, in the 27 EU member states; facilitators will become the deemed supplier responsible for VAT on third-party import sales if the consignment intrinsic value doesn’t exceed €150. [France may go a step further](#) and make marketplace facilitators the deemed supplier on all import transactions.

### [Brexit and the U.K. ecommerce package will complicate tax compliance for companies with business dealings in the U.K.](#)

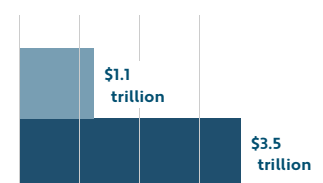
Effective January 1, 2021, marketplace facilitators will be responsible for charging and reporting VAT



#### Business-to-business marketplace sales:



#### Business-to-consumer marketplace sales:



on facilitated import sales valued at or below £135. Online marketplaces will also be the deemed supplier responsible for VAT on sales by non-U.K. sellers of goods of any value that were already in the U.K. This doesn't apply when the marketplace seller is a resident of the U.K.

Imported goods valued above £135 will use the existing import VAT procedures: Sellers with a U.K. VAT number may pay the import VAT (and duties) on clearance, then reclaim them. Alternatively, the seller may opt to have customers pay at customs or to the delivery agent.

This is a confusing situation for businesses, and we're only scratching the surface here. Follow the [VATlive blog](#) for the most up-to-date information.

## REQUIREMENTS FOR MARKETPLACE SELLERS

Although [marketplace facilitators in the U.S. must collect and remit sales tax on behalf of third-party sellers](#) in most states, [marketplace sellers may still have to register](#), file returns, and document tax-exempt sales.

No matter the channel, exempt sales must be validated by a properly completed exemption certificate. Thus, B2B sellers need to understand how each marketplace handles exempt sales, and what, if anything, sellers and their customers need to do.

For example, the [Amazon Tax Exemption Program](#) (ATEP) allows qualifying businesses or individuals to make tax-exempt purchases from Amazon, its affiliates, and third-party vendors that participate in the program. Yet unless sellers take all necessary steps, [sales tax may be applied to what should be a tax-exempt sale](#).

At the start of 2020, only **five states** with a statewide sales tax hadn't adopted a marketplace facilitator law. Now that [Louisiana](#) and [Mississippi](#) have done so, there are only three left: Florida, Kansas, and Missouri. As noted, all are moving toward requisite marketplace collection, albeit slowly.

As with marketplace facilitators, obligations for marketplace sellers are a bit different in the EU. [Both EU and non-EU sellers should benefit from reduced VAT obligations starting July 1, 2021](#): For imports not exceeding €150, the facilitator will charge customers VAT at the point of sale and declare it for imports.

Marketplace sellers with inventory in U.K. fulfillment centers may be affected by new inventory storage limits. As [Amazon](#) explains it, where previously there was one set of storage limits that applied across the U.K. and Europe, effective January 1, 2021, there will be one set of storage limits for the U.K. and a second set of storage limits for inventory in the EU.

Follow breaking developments at [2021 EU & UK ecommerce VAT reforms](#).

## HALF A MEAL IS BETTER THAN NOTHING: ONLINE SALES BOOST HARD-HIT RESTAURANT INDUSTRY

Though the pandemic has put restaurants in a pickle, takeout and delivery sales are helping keep the doors open. About 42% of restaurants surveyed earlier this year said they **added delivery services due to the pandemic**, and 31% said they planned to continue to invest in delivery services post-pandemic.

The taxability of takeout can be affected by the amount of food sold to go vs. for here, whether cutlery is supplied, even the temperature of the food sold. It all depends on the state. For example, in Ohio, while food consumed at a restaurant is taxable, food sold for consumption off premises generally isn't. By contrast, the taxability of takeout in New York often hinges on whether the food is heated or unheated.

Some diners like ordering directly from restaurants, but many now prefer going through food-delivery marketplaces like DoorDash and Grubhub. Who makes the sale (i.e., the restaurant or a third party) can impact how it's taxed, as can who makes the delivery. **While on-premises dining is almost always subject to sales tax, takeout may or may not be.**

For example, **Georgia** and **North Carolina** recently made food-delivery marketplaces responsible for collecting sales tax, but Mississippi adopted an **exemption for third-party food delivery providers**. In Nebraska, whether **tax applies to delivery service charges** depends on who arranges the service (i.e., the customer or the restaurant), and if the delivery charges are separate or included. In California, delivery marketplaces aren't responsible for collecting and remitting sales tax unless they elect to do so.

States are likely to continue to fine-tune their marketplace sales tax laws in 2021, to account for food-delivery platforms as well as lodging and travel platforms. The National Conference of State Legislatures has drafted **model marketplace facilitator sales tax legislation**

Exempt:  
Takeout



Restaurant food  
in Ohio



Taxable:  
Dine-in

Exempt:  
Unheated



Takeout food  
in New York



Taxable:  
Warm

to encourage uniformity between state laws, but many states may choose to develop their own laws to suit their own needs.

## GROCERIES: OUT OF THE CART AND INTO THE CUPBOARD

Online sales of groceries have also increased considerably during the pandemic, potentially creating new sales tax obligations for growing ecommerce grocery vendors. In the early days of the pandemic, **online grocery sales grew by 300%**.

### **Food for home consumption tends to be subject to different tax rates**

and rules than tangible personal property. For example, groceries are generally exempt in numerous states (e.g., California and Texas) and taxed at a reduced rate in others (e.g., Missouri and Utah). While most food for home consumption is taxed at a reduced state sales tax rate in Tennessee, the full local sales tax rates apply. In Colorado, too, local tax may apply even though state sales tax doesn't. And in Alaska, whether local sales tax applies to non-prepared food can depend on the season: winter, spring, summer, or fall.

Certain foods and drinks, such as candy and sugary beverages, are often subject to different rates. And rates for all products are subject to change: Wyoming eliminated the sales tax on groceries in 2006, made the exemption permanent in 2007, and (as we noted earlier) may **reinstitute the tax** due to revenue shortfalls caused by the pandemic.

In response to COVID-19, **many brick-and-mortar grocers have increased online grocery capacity** to facilitate delivery or curbside pickup. These sales may be taxed differently than in-store sales. For example, the delivery address may have a different rate of tax than the store. And while New Mexico allows retail food stores to claim a gross receipts tax deduction for the sale of food for home consumption, **the deduction may not apply to sales of groceries that are delivered**; taxability can be impacted by such factors as the type of retailer and who arranges and pays for the delivery (i.e., the customer or the retailer).



**The Food Industry Association has seen a dramatic boom in online grocery sales:**

*"We've experienced seven years of online growth in seven months."*



**Grocery foods may be subject to different tax rates than other goods, and candy and sugary drinks are often taxed at special rates.**

# Brick-and-mortar retailers find creative ways to survive

Brick-and-mortar retailers that have been struggling to compete with online sellers for years were dealt another blow when they were forced to close or operate at reduced capacity for months last spring. The resurgence of COVID-19 cases this winter has brought additional restrictions and challenges in some states, as has the fact that some consumers are voluntarily limiting time in stores to reduce the likelihood of contagion.

To stay afloat, numerous businesses are embracing multichannel selling. Retailers with established online stores have been best able to adapt. Those with no online presence have had to scramble to develop new sales channels, such as selling through marketplaces, developing their own ecommerce store, or expanding curbside pickup options like buy online, pickup in store (BOPIS).

## BRICKS MEET CLICKS

The pandemic has driven even the most die-hard in-store shoppers online, out of necessity. The Organisation for Economic Co-operation and Development (OECD) finds COVID-19 has “**expanded the scope of ecommerce**, including through new firms, consumer segments (e.g., elderly) and products (e.g., groceries).” And data from IBM’s annual U.S. Retail Index study suggests COVID-19 has **accelerated the shift toward ecommerce by about five years**.

**It’s no small feat to build an online store** and drive traffic to it. But once created, online stores can complement physical stores. They may also lead to new sales tax compliance challenges.



*Those with no online presence have had to scramble to develop new sales channels, such as ... expanding curbside pickup options like buy online, pickup in store (BOPIS).*



*COVID-19 has accelerated the shift toward ecommerce by about five years.*

For example, since most states base sales tax on the destination of the sale, online sales shipped to different locations – even the neighboring town – may be subject to different tax rates than in-store sales. And if enough sales are made to customers in other states, retailers can establish economic nexus and an obligation to collect and remit sales tax in those states.

## RISE OF BOPIS UNDERSCORES NEED FOR ROBUST POS SYSTEMS

Having an online store can also encourage consumers to buy online and pick up in store.

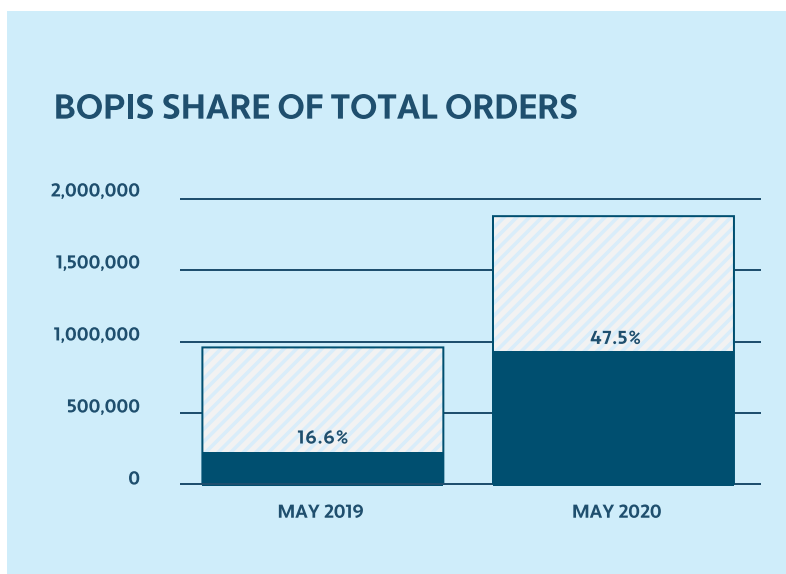
Already trending, BOPIS has become more prevalent during the pandemic: There were **six times** more BOPIS purchases in April 2020 than in April 2019. Perhaps that's why **90% of retailers plan to offer BOPIS by 2021**. For brick-and-mortar retailers that sell online, it's a great way to merge the bricks with the clicks.

Yet **BOPIS also creates unique challenges**. It requires training staff to ensure smooth customer interactions and establishing systems to identify and prevent fraud. For companies that sell in store as well as online, it can complicate inventory tracking and logistics.

BOPIS can also muddle sales tax compliance, since orders packed for delivery may be subject to different tax rates or rules than orders packed for pickup in store. Much depends on the **sales tax sourcing rules**, which can be based on the location of the seller (origin sourcing), the location of the consumer (destination sourcing), or a mix of both (mixed sourcing).



*If enough sales are made to customers in other states, retailers can establish economic nexus and an obligation to collect and remit sales tax in those states.*





Since BOPIS is likely to become even more predominant in 2021, having a point-of-sale (POS) system that can sync physical and online orders and apply the proper sourcing rules to get the tax right on both will become increasingly essential. Otherwise, a BOPIS sale could end up being taxed at the rate in effect at the customer's billing address rather than the rate of the location where the purchase is picked up.

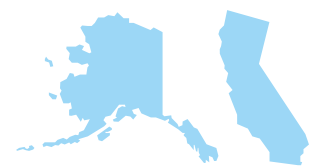
## MARKETPLACES OFFER NEW SALES CHANNELS

Selling through marketplaces is another way for traditional brick-and-mortar retailers to reach new markets. Although in-person sales contracted in 2020, **Amazon added approximately 400,000 jobs**, primarily in warehouses and delivery operations. And Amazon wasn't alone: Walmart's online sales nearly doubled during the second quarter of 2020, allowing the company to "**increase the size of its online marketplace**, add new brands, and improve the product mix."

As we've explained, selling through marketplaces can create new sales tax obligations for third-party sellers. Although most marketplace facilitators are required to collect and remit tax on behalf of third parties in most states, marketplace sellers may still develop registration and reporting obligations.

It's important for omnichannel sellers to have a comprehensive view of all sales made. Without that, they risk establishing nexus without realizing it. Alaska and California are two states that require remote sellers to include direct sales and marketplace sales when **calculating the economic nexus threshold**.

Declines in foot traffic caused by COVID-19 are prompting many brick-and-mortar retailers to sell through new channels. Those used to dealing with sales tax at one location may be surprised by how complex compliance can become once additional factors are involved, such as online sales, marketplace sales, and BOPIS.



**Alaska and California are two states that require remote sellers to include direct sales and marketplace sales when calculating the economic nexus threshold.**

# Services and events need online options

2020 made in-person out, and online in. That will continue to be the case in 2021 – and could affect the taxability of events.

With so many unknowns surrounding vaccine development and distribution, many businesses and schools will likely continue to proceed with caution, operating virtually rather than in person for months to come. The same will likely be true for entertainment and socializing.

We don't yet know exactly how these developments will affect sales tax. We do know businesses constantly strive to meet the changing demands of consumers, and governments, in turn, adjust tax laws to keep pace with evolving business models. It's like a never-ending game of Catch Me If You Can, and it can create serious headaches for businesses. [Avalara keeps a finger on the pulse of ever-changing tax laws](#) and makes sure businesses are informed.

## YOU CAN WEAR YOUR PJS: VIRTUAL B2B AND B2C EVENTS ARE HERE TO STAY

After countless in-person events had to be canceled during the early days of the pandemic, businesses showed their resilience by quickly pivoting to online events. The good news: Virtual events can draw broader audiences, some of whom would never attend an in-person event. The bad news: [Virtual events can have unexpected sales tax consequences](#).



*Virtual events can draw broader audiences, some of whom would never attend an in-person event ... [but] virtual events can have unexpected sales tax consequences.*

States categorize different events differently. If speakers educate attendees on issues, a conference could be categorized as “training and seminar,” yet because it takes place online, it could be categorized as “online training” or simply “software.” Prerecorded sessions could be categorized as “videos” or “video programming streamed over the internet.” Or something else altogether. It’s essential to categorize events properly because different categories may be taxed differently in each state.

**Determining taxability is especially challenging when software or software as a service (SaaS) is involved.** In 2013, the **Massachusetts Department of Revenue** ruled that sales of subscriptions to a company’s Virtual Event Center (VEC), whether sold alone or bundled with additional offerings, were taxable as software. Yet separate sales of the company’s event project management services may be exempt personal or professional services.

So, it’s complicated.

The same is true for more relaxing events, whether part of a team-building exercise at work or among family and friends. Many such activities involve both products and services, such as a virtual wine tasting event, and that can impact taxability. A standalone charge for a service (e.g., a wine tasting class) may be taxable or exempt, while charges for wine are generally taxable. The taxability of a bundled charge for goods and services can go either way, but tend toward taxable in most states if they include a taxable sale.

The growing predominance of virtual events could pique the interest of tax officials and state lawmakers in the months to come, especially in states with pandemic-related deficits.

**Exempt:**  
**Separate sales of  
company’s event project  
management services**



**Software or SaaS  
in Massachusetts**



**Taxable:**  
**Sales of subscriptions  
to company’s VEC**

## TURN ON YOUR CAMERA: ONLINE EDUCATION AND TRAINING SPARK TAX RULINGS

Similar complexities may arise with online education, which has become widespread during the pandemic. Students of all ages, from kindergarten to adult, are attending school online rather than in person. The same is true for exercise classes, music classes, cooking classes – anything that can be taught over FaceTime, Zoom, or similar platforms is being taught over FaceTime, Zoom, and similar platforms.

As with B2B events, **the taxability of online classes can hinge on many factors**. In Wisconsin, for example, live digital online educational services are generally exempt but prerecorded seminars and webinars are generally taxable whether downloaded or streamed. Similarly, live, instructor-led classes are generally exempt in Tennessee while **self-paced online classes with no online instruction are generally taxable**.

Exempt:  
Live digital  
online education



Online classes  
in Wisconsin



Taxable:  
Prerecorded seminars  
and webinars

### Borderless classrooms can lead to sales tax liability in other states:

*“A school can establish sales tax nexus like a business, through physical presence in a state – including traveling representatives or recruiters. Yet in most states, physical presence isn’t the only way for an out-of-state entity to establish sales tax nexus: A remote entity can create nexus solely through sales activity in a state, or economic nexus.”*

Taxability can also depend on how a class is categorized. Is it considered part of a gym or club membership? If so, it could be subject to sales tax in [Tennessee](#). Or not. According to the [Tennessee Department of Revenue](#), spin classes offered by fitness

facilities are generally taxable but a karate class would generally be exempt. Adding another layer of complexity, such as transferring a class online, can really cause a person to break out in a sweat because it may change the way the class is defined for tax purposes, and therefore taxed.

And of course, when classes aren't held in person, instructors and students don't need to be in the same location. Thus, a yoga instructor based in Washington, D.C., where yoga is taxable, may have a student in Missouri, where instructional classes are exempt. Whether the charges for that class would be taxable under D.C.'s law or exempt under Missouri's depends on **how the sale is sourced** (i.e., which jurisdiction's rules apply, those at the location of the seller, the location of the buyer, or a combination of both).

With online classes now commonplace, these are questions businesses, and tax authorities, must answer. 2021 could bring more action on this front.

**Exempt:**  
**Karate class**



**Fitness classes  
in Tennessee**



**Taxable:**  
**Spin class**

# Manufacturers adapt and pivot to survive pandemic

The COVID-19 pandemic hit manufacturers hard. Industry leaders say it “**accelerated many trends that were already appearing**,” such as expanding B2C sales and B2B marketplace transactions. Some of these may have tax implications.

## COVID-19 THROWS WRENCH IN MANUFACTURING SUPPLY CHAINS

Plant closures in China and elsewhere **disrupted global supply chains**, slowing or altogether stopping production lines the world over. Once manufacturing resumed, a lack of truck drivers, restrictions on shipping, and a reduction in flights slowed the movement of goods. “**Stockpiling and panic buying by consumers**” only increased the strain on supply chains.

The burgeoning movement to reduce reliance on China got a boost from the pandemic. In a February 2020 **survey of over 1,000 North American manufacturing and industrial suppliers**, “over half of manufacturers” surveyed said they’re “‘likely to extremely likely’ to bring production and sourcing back to North America. Additionally, 47% of U.S. manufacturers report they are now seeking domestic sources of supply.”

At the same time, sudden drops in demand for existing products inspired some companies to completely retool their business, go-to-market strategy, and operations in order to **meet rising demand for new products**. For example, clothing manufacturers in New York, Los



**February 2020 survey of over 1,000 North American manufacturing and industrial suppliers:**

**>50%**

‘Likely to extremely likely’ to bring production and sourcing back to North America

**47%**

Currently seeking domestic sources of supply

Angeles, and Virginia began producing masks and protective gowns instead of fashionable clothing and bathing suits. This led to new customers and, in some cases, new selling models.

Manufacturers have had to navigate these and other changes despite staffing challenges caused by stay-at-home orders and remote work requirements. They've had to develop safe working conditions for on-site employees and new protocols for remote employees. Many also created new digital sales models to enhance virtual selling in response to interrupted physical sales cycles; in some industries, these have proven to be "**equally or more effective** in reaching customers than their former sales methods."

## B2B AND B2C ECOMMERCE AND MARKETPLACE SALES ON THE RISE

The new environment has placed **an emphasis on B2B ecommerce**, which wasn't necessarily a priority previously. Worldwide, B2B ecommerce growth is now outpacing B2C ecommerce, though manufacturers are also expanding B2C sales.

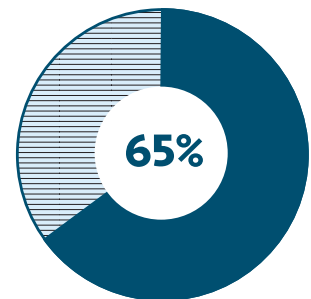
According to a survey on industry trends conducted by Alexander Group, "As face-to-face customer contact diminishes, **manufacturers are re-thinking their channel strategies**. Approximately 20% of manufacturers have their own ecommerce channels, while others are prioritizing distributors with full online capabilities." To better compete, some firms are heavily investing in ecommerce platforms and bypassing normal wholesale and distribution channels so they can sell directly to consumers.

## NEW MARKETS LEAD TO NEW SALES TAX OBLIGATIONS

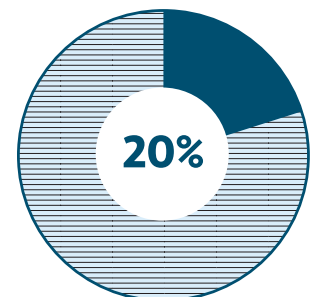
Surging B2B and B2C online sales could create new tax compliance obligations for manufacturers. **Businesses dealing primarily or even exclusively in exempt transactions** aren't immune from economic nexus.



**About 65% of B2B decision makers surveyed in April 2020 believe new go-to-market sales models are equally or more effective than pre-COVID-19 models.**



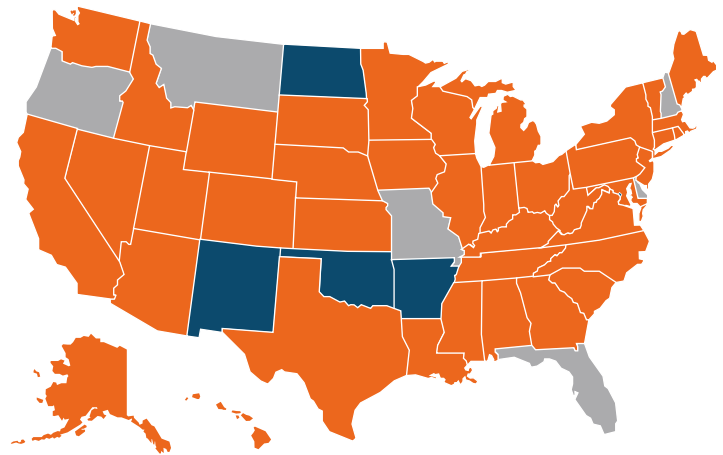
**Approximately 20% of manufacturers have their own ecommerce channels.**



Although some states exclude exempt sales from their economic nexus thresholds (or may not require some wholesalers to register), **other states include exempt sales** in the threshold count. Thus manufacturers, resellers, and wholesalers may need to register and file returns in addition to collecting and managing exemption certificates on B2B transactions. Businesses that have grown B2C sales may have additional collection or reporting requirements.

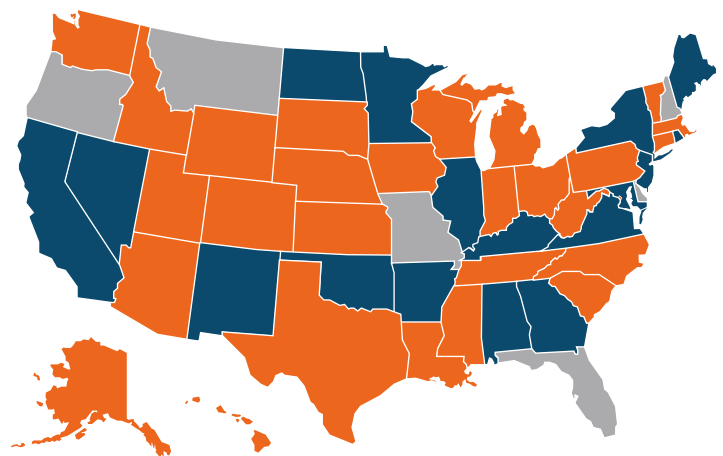
### ARE EXEMPT SALES INCLUDED IN STATES' ECONOMIC NEXUS THRESHOLD?

- Included
- Not included



### ARE EXEMPT SERVICES INCLUDED IN STATES' ECONOMIC NEXUS THRESHOLD?

- Included
- Not included





Selling through marketplaces can also create new sales tax obligations for manufacturers – and, as stated earlier, B2B marketplace sales are growing. According to a senior analyst at Forrester Research, “Manufacturers (and resellers, to some extent) have been experimenting with **selling through marketplace digital channels** for some time now ... [and] COVID-19 accelerated this trend because of the demand disruption it caused.”

With B2B ecommerce on track to grow in 2021, manufacturers may find it necessary to better integrate ecommerce into their operations. They should also carefully consider customer experience, and whether their ecommerce platforms and tax compliance practices help or hinder customer loyalty.

Unless an ecommerce platform is set up to allow exempt transactions, customers may be required to pay sales tax on purchases that should be exempt. Alternatively, customers may be blocked from completing an exempt purchase until they contact the seller and provide a valid exemption certificate. And if exempt transactions are allowed to proceed without validation, the seller may be exposed to audit risk.

Fortunately, there are ways to validate exempt ecommerce sales. Some ecommerce platforms integrate with external exemption certificate management solutions, while others offer add-on solutions. Either option can improve customer experience by **enabling businesses to digitally collect, validate, and store exemption certificates**.

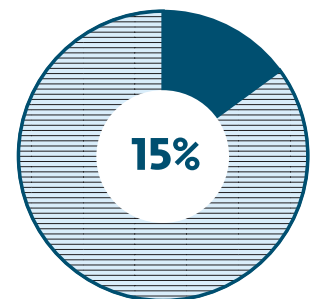
Finally, manufacturers expanding into international markets should consider the cross-border and global tax implications of ecommerce. Demand for cross-border ecommerce is growing – it’s expected to account for **more than 15%** of the world’s online retail market by 2022. Businesses selling internationally need to be able to **calculate customs duties and import taxes at checkout** to mitigate compliance risks and avoid surprising customers with unexpected costs at delivery.



**[Manufacturers] should also carefully consider customer experience, and whether their ecommerce platforms and tax compliance practices help or hinder customer loyalty.**



**Cross-border ecommerce may account for 15% of all online retail by 2022.**



# Software industry faces unique tax challenges

Like manufacturers, businesses in the software industry face particular tax challenges. Software taxability is full of complexity and contradictions, making the taxability of these products difficult to comprehend and even more difficult to get right.

## SOFTWARE SALES TAX LAWS ARE INCREDIBLY COMPLEX

**Software products and services are taxed 450 different ways across 45 categories.** Taxability can hinge on a number of factors, including whether the software is custom or canned, digital or physical. In some states, physical sales of software are subject to sales tax but digital sales are exempt. SaaS may also be taxed differently from software that doesn't include a service, or sales including both software and SaaS.

For example, in New York, sales of cloud services, SaaS, and prewritten software delivered on physical media or electronically are taxable, while sales of custom software delivered electronically or on physical media are exempt, as is the customization of canned software. Thus, **before tax can be properly determined, taxability laws need to be fully understood.**

Getting sales tax right is further hindered because some states apply a reduced rate to software products or SaaS rather than the general rate, and some states tax only a percentage of the charges. Furthermore, tax can vary depending on where the purchase occurred or who purchased it.

Exempt:  
Custom software

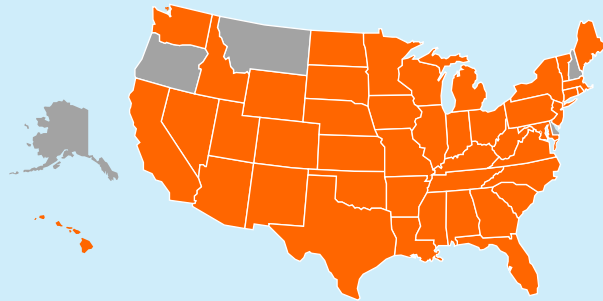


Software  
in New York



Taxable:  
Prewritten software

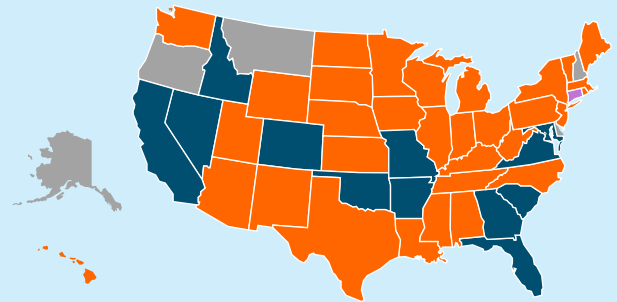
**CANNED SOFTWARE DELIVERED ON TANGIBLE PERSONAL PROPERTY**



■ Taxable
 

CT	DC	MA	
MD	NJ	RI	VT

**CANNED SOFTWARE DOWNLOADED**

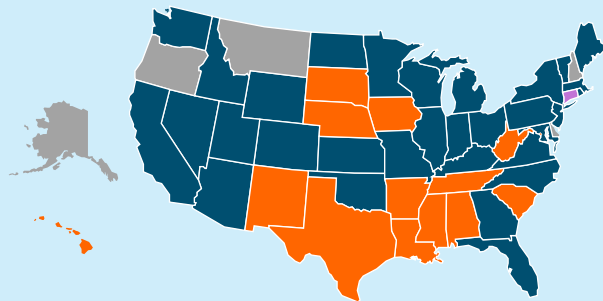


■ Taxable
 

CT	DC	MA	
MD	NJ	RI	VT

■ Exempt
   
■ Taxed at 1%

**CUSTOM SOFTWARE DELIVERED ON TANGIBLE PERSONAL PROPERTY**

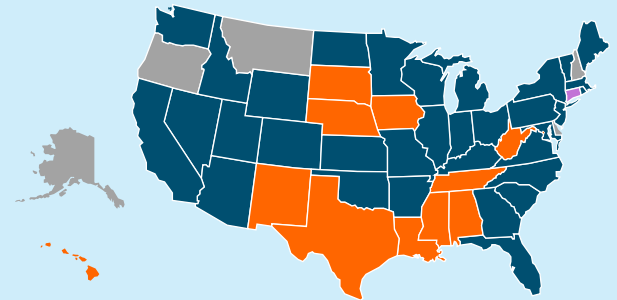


■ Taxable
 

CT	DC	MA	
MD	NJ	RI	VT

■ Exempt
   
■ Taxed at 1%

**CUSTOM SOFTWARE DOWNLOADED**

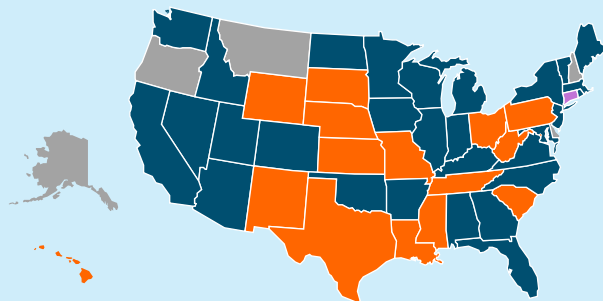


■ Taxable
 

CT	DC	MA	
MD	NJ	RI	VT

■ Exempt
   
■ Taxed at 1%

**CUSTOMIZATION OF CANNED SOFTWARE**

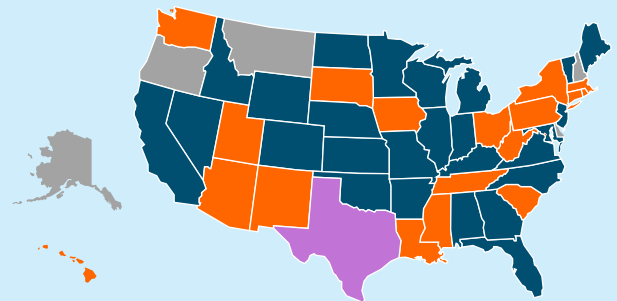


■ Taxable
 

CT	DC	MA	
MD	NJ	RI	VT

■ Exempt
   
■ Taxed at 1%

**SOFTWARE AS A SERVICE**



■ Taxable
 

CT	DC	
MA	MD	
NJ	RI	VT

■ Exempt
   
■ 80% of the charges are taxable

The rules can be counterintuitive. Some examples of this:

- Digital games are taxed in 35 states, D.C., and Puerto Rico when ownership is permanent, but only in 29 states and D.C. when ownership is temporary.
- Software services that are exempt from Colorado state sales tax may still be subject to local sales taxes.
- Software training associated with the sale of on-premises software is subject to tax in nine states, D.C., and Puerto Rico; but software training not associated with a sale is taxed in only six states and Puerto Rico.

It's enough to drive even the most assiduous programmer mad, and when subscription sales are added to the mix, it becomes even more complicated. Recurring billing can be fixed or variable, meaning the payment can be the same every billing cycle (fixed) or fluctuate depending on the amount of transactions made (variable). And of course, the billing method can affect sales tax compliance because of the way invoice adjustments, refunds, and other issues are handled.

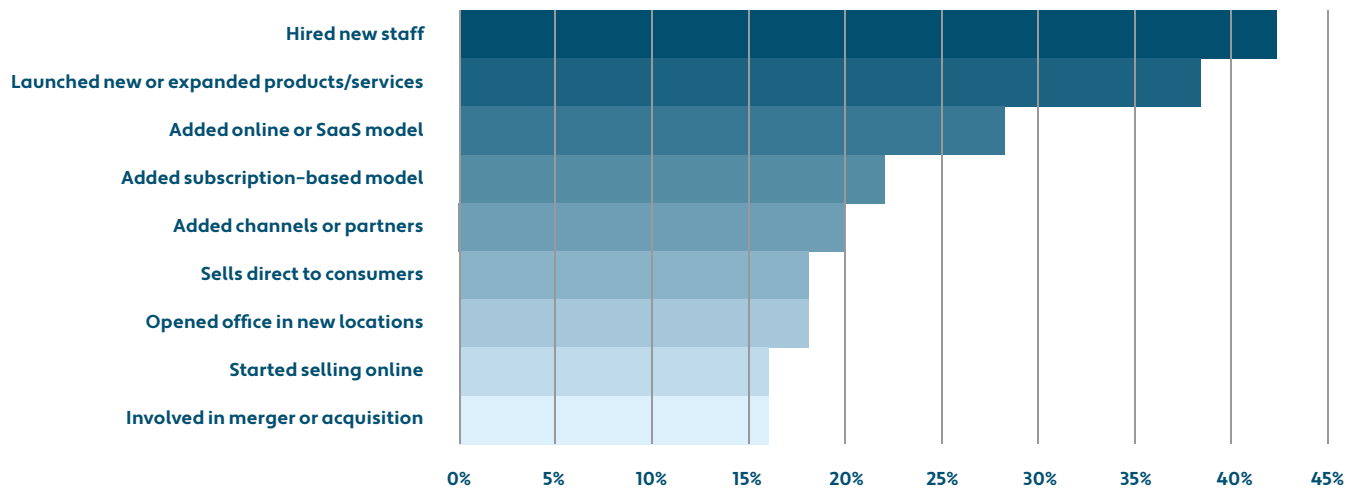
## **SUCCESSFUL SOFTWARE INDUSTRY GRABS ATTENTION OF LAWMAKERS AND TAX AUTHORITIES**

Software companies need to be able to get sales tax right because they're increasingly required to collect and remit it. The rapid growth of the software industry in recent years has inspired some state and local governments to develop new tax policies in order to increase collections from software companies.

**[A survey conducted by Avalara and MKG](#)** found that software companies typically engage in nine activities that can trigger new sales tax obligations. These include selling online or directly to

consumers, migrating products or services to the cloud, and adding new products or services, such as subscription-based or SaaS models.

## NEXUS TRIGGERING EVENTS FOR SOFTWARE COMPANIES



Hiring new staff or contractors, opening offices in new locations, and being involved in an acquisition or merger can also create new tax obligations, as they often result in an expanded physical footprint.

## REMOTE SALES TAX LAWS IMPOSE NEW COLLECTION REQUIREMENTS ON SOFTWARE BUSINESSES

Economic nexus laws have increased the sales tax burden of many software companies, which typically have customers in multiple states and other countries. Today, 43 states, D.C., and some parts of Alaska may require software and SaaS sellers to register then collect and remit sales tax simply due to their volume of sales in the state.

And economic nexus isn't the only remote sales tax law affecting the software industry. Under affiliate nexus and click-through nexus,

relationships with affiliates, digital advertising, and online referral programs can trigger new tax obligations.

Some state economic nexus laws only apply to sellers of tangible personal property; others apply to tangible goods as well as digital goods and services. In order to determine whether economic nexus has been established, companies need to understand which sales count toward the economic nexus threshold. In some states, digital goods and services may fall under the definition of tangible goods and services. In others, they're specifically called out. It's different in every state.

The fast-growing nature of the software industry can work against it when it comes to sales tax. It can catch companies off guard, so they don't realize new tax obligations have been triggered. This can lead to large tax liabilities.

Though sales tax laws are subject to frequent change, they can be slow to adapt to quickly changing industries like software and SaaS. As a result, it's not always apparent how certain sales are to be treated for tax purposes. Nonetheless, the onus is on the seller to get sales tax right.



*The fast-growing nature of the software industry can ... catch companies off guard, so they don't realize new tax obligations have been triggered.*

# STAYING INFORMED

## 2021 will be better. Right?

As we say *good riddance* to 2020, we'll do our best to help you prepare for whatever 2021 brings. This report highlights big changes but is by no means exhaustive, so we invite you to:

- Check out the [\*\*Avalara sales tax resource hub\*\*](#)
- Go to the [\*\*Avalara Commerce Monitor\*\*](#) for insights our data reveals on manufacturing, retail, and services
- Read the [\*\*Avalara blog\*\*](#) for up-to-date news on all things sales tax
- Visit our [\*\*COVID-19 tax info hub for business recovery\*\*](#)
- Visit our [\*\*Brexit info hub\*\*](#)

Or give us a call at 877-759-6520. [\*\*Automating tax compliance\*\*](#) is an effective way for businesses to track and comply with the ever-changing world of sales and use tax laws.

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Seattle, WA 98104

877-759-6520

[\*\*avalara.com\*\*](#)