Essential Guide to Sales and Use Tax *for small business*

Congratulations! Your business is growing. You are doing things right and orders are starting to really take off. You are expanding into new markets with new products and services.

Now, you find yourself so busy that it's becoming hard to keep up. You put on extra staff, upgrade your equipment, and start getting serious about competing with the big boys. You don't want to let your sales tax compliance be one of the things that get overlooked in your race to the top.

Staying in compliance with state sales tax laws can be one of the toughest challenges a growing business faces. So Zip2Tax has put together this quick guide covering sales and use tax basics.

This is not designed to be a definitive legal source, or replace the advice of a good certified public accountant, but it will show you the areas you may need to understand better. Make sure you have covered these basics and you are well on your way to staying in the auditor's good graces.

What is sales tax?

A form of excise duty collected by states and sometimes municipalities when non-exempt tangible personal property (TPP) is exchanged in a retail transaction. Sales taxes are owed by the purchaser but are generally collected by the retailer.

What is use tax?

Use tax is owed by the purchaser any time sales tax has not been collected on a taxable transaction such as a purchase made from another state.

When is tax applied?

A retail sale is considered a taxable event. Each state has its own definition for what is considered a retail sale, but generally, all sales of TPP to a consumer are presumed to be taxable unless a specific exemption applies.

You can't make this stuff up:

If a purchaser pays sales tax on a transaction at a lower rate than the rate in their home jurisdiction, the purchaser owes the difference in use tax.

What is taxable?

Goods and property - anything with physical substance - are generally taxable. Services are generally not taxable if they are not integrated into the sales price of TPP. There are many exceptions to these rules.

zip2tax.com
Zip Code Lookup of Sales Tax Jurisdictions

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866-492-8494

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INSIDE

State-specific information

Alabama	(334) 242-1490
Alaska	(907) 269-4605
Arkansas	(501) 682-1895
Arizona	(602) 255-2060
California	(800) 400-7115
Colorado	(303) 238-7378
Connecticut	(860) 297-5962
Delaware	(302) 577-8205
Florida	(800) 352-3671
Georgia	(877) 423-6711
Hawaii	(808) 587-4242
Iowa	(515) 281-3114
Idaho	(800) 972-7660
Illinois	(800) 732-8866
Indiana	(317) 232-2240
Kansas	(785) 368-8222
Kentucky	(502) 564-4581
Louisiana	(225) 219-2448
Massachusetts	(617) 887-6367
Maryland	(410) 767-1300
Maine	(207) 624-9693
Michigan	(517) 636-4486
Minnesota	(800) 657-3777
Missouri	(573) 751-2836
Mississippi	(601) 923-7000
Montana	(406) 444-6900
North Carolina	(877) 252-3052
North Dakota	(701) 328-2770
Nebraska	(402) 471-5729
New Hampshire	(603) 230-5000
New Jersey	(609) 826-4400
New Mexico	(505) 827-0908
Nevada	(866) 962-3707
New York	(518) 485-2889
Ohio	(800) 282-1780
Oklahoma	(405) 521-3160
Oregon	(503) 378-4988
Pennsylvania	(717) 787-1064
Rhode Island	(401) 574-8955
South Carolina	(803) 896-1420
South Dakota	(800) 829-9188
Tennessee	(615) 253-0700
Texas	(800) 252-5555
Utah	(800) 662-4335
Virginia	(804) 367-8031
Vermont	(802) 828-2551
Washington	(800) 647-7706
Wisconsin	(608) 266-2772
West Virginia	(304) 558-3333
Wyoming	(307) 777-3745

Rules Of Thumb

Each state and province has its own set of jurisdictional tax laws

Laws on the taxability of certain items, services, and business types vary considerably from state to state. Zip2Tax's data pertains to general sales and use tax only (with the exception of clothing in New York State), and we do not gather information specific to individual state laws.

For tax questions other than general sales and use rates, the best source of information is the state itself. At left is a phone directory for the revenue departments of each state.

States With No Sales Tax: Delaware, Montana, New Hampshire and Oregon

States Without Sales Tax But Some Municipalities Levy Taxes: Alaska

States That Levy A State-Wide Sales Tax: Connecticut, Idaho, Indiana, Kentucky, Massachusetts, Maryland, Maine, Michigan, Mississippi, New Jersey, Rhode Island, Virginia and West Virginia.

States That Levy A State-Wide Sales Tax As Well As County Taxes: Florida, Hawaii*, Nevada, North Carolina, Ohio, Wisconsin and Wyoming

States With A State-Wide Sales Tax As Well As County And Municipal Taxes: Alabama, Arizona, Arkansas, California, Colorado, Georgia, Hawaii*, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont and Washington

States With No Use Tax: Delaware, Montana, New Hampshire and Oregon

States With A Use Tax That Is Not The Same As The Sales Tax: Alabama, Arizona, Colorado, Missouri And Oklahoma

States With A State-Wide Use Tax, But No Local Use Taxes: Iowa, Illinois, New Mexico, Vermont and Wisconsin

Provinces And Territories Participating With The Harmonized Sales Tax: British Columbia, New Brunswick, Newfoundland and Labrador, Nova Scotia and Ontario

Provinces And Territories Using An Individual Retail Sales Tax: Manitoba, Prince Edward Island, Saskatchewan and Quebec**

Provinces And Territories Requiring Only The Goods and Services Tax (GST): Alberta, Northwest Territories, Nunavut and Yukon

**Technically, Hawaii has an excise tax, not a sales tax.*

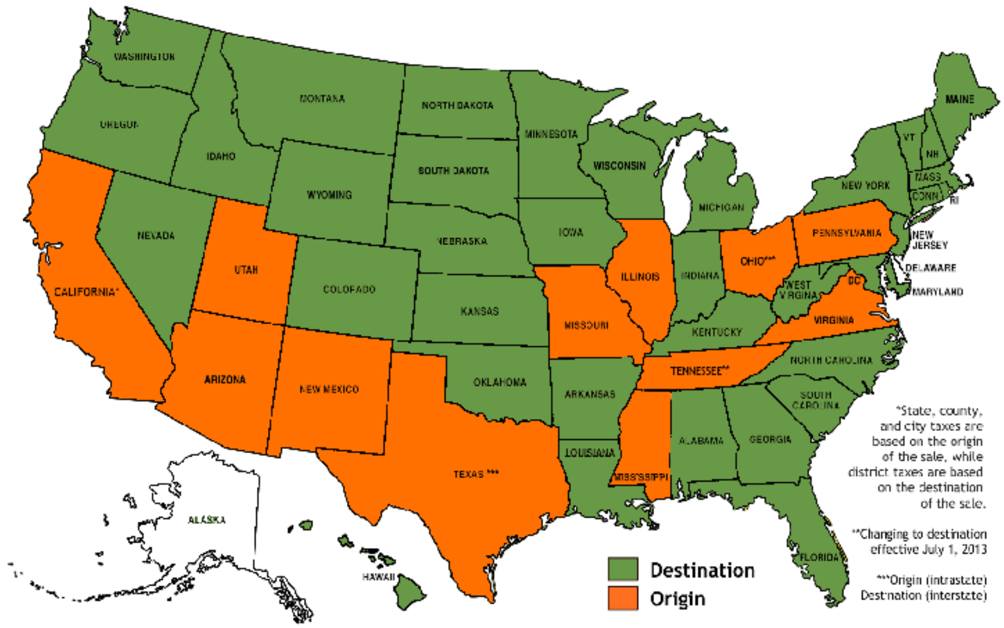
***Quebec administers both the federal GST and its own Quebec Sales Tax (QST).*

As of November 2012, the following states tax shipping:

Arkansas	Michigan	New Mexico	Tennessee
Connecticut	Minnesota	New York	Texas
Georgia	Mississippi	Ohio	Vermont
Hawaii	North Carolina	Pennsylvania	Washington
Indiana	North Dakota	Rhode Island	West Virginia
Kansas	Nebraska	South Carolina	Wisconsin
Kentucky	New Jersey	South Dakota	

Are the taxes origin or destination-based?

Sales Tax Sourcing



It's important for businesses to know not only which sales tax laws apply to the products and services they provide, but also whether the source of the sales tax rate is based on origin or destination.

The majority of states have a destination-based sales tax. This means the sales tax applied to a purchase is determined by the jurisdiction where the product is received by the purchaser. This can be the address that a purchase is shipped to or the location that the customer takes possession of the merchandise.

Destination-based systems can be complicated for retailers because the burden of staying up to date with ever-changing tax rates for all jurisdictions within the state or states in which they have nexus falls upon the retailer. Filing tax returns in these states can be doubly complicated since some require the retailer to precisely track and break their sales down for each jurisdiction.

There are several states where sales taxes are origin based. Sales taxes in these states originate from the point of purchase regardless of where the customer receives the merchandise. This method is much simpler for the merchants.

In an interesting exception to the two sourcing bases already mentioned, California is considered a modified origin state. While sales taxes are origin based at the state, county, and city levels, special districts are destination based.

Alaska proves to be its own special case. The state doesn't impose any sales or use tax, but various boroughs and municipalities do. There is no uniformity between these municipalities and no ordinance can be considered "typical," so Alaska is essentially non-classifiable at a state-wide level.

What states do you do business in?

The Question of Nexus

Navigating sales and use tax compliance can be tricky. There are a number of factors, varying from state to state, that determine whether your business needs to collect and remit sales tax. One of the more complex is nexus.

Nexus is an ever-growing, ever-evolving way for states to raise revenue, particularly in this Internet age. Different definitions of nexus across different states creates a regulatory maze that can be tricky to navigate.

Traditionally, nexus was established when a business had a physical presence, a "brick and mortar" building such as a retail store or warehouse, within a tax jurisdiction. This definition expanded when it became common for a salesperson or other employee to do business on behalf of a company in a given territory. Rules became even more murky when some states started considering a business person's presence at a trade show enough to create nexus.

Now, in the Internet age, nexus can be established just by advertising within a jurisdiction. Ever since New York state enacted the first click-through nexus law in 2008, many other click-through nexus laws have been put on the books and others are still in the proposal stages. Out-of-state retailers who operate what is known as an "affiliate program," in general, are required to register in-state so that sales taxes can be collected and remitted.

In an affiliate program, generally speaking, an in-state "affiliate" provides a link on a web site back to the "seller's" web site and collects a commission on resulting sales. Depending on the location of your affiliate, you may be required to collect and remit state sales tax for this type of activity.

Not to be confused with affiliate programs is something known as agency, or affiliate, nexus. If you are a retailer who is part of a group of corporations that happens to have a component retailer member that is engaged in business in-state, your business may be presumed to have nexus in that state as well. One state with such a law on the books is Oklahoma (Okla. Stat. tit. 68 section 1401(9)(d)), with several other states either proposing or enacting similar legislation.

Court rulings continuously redefine what constitutes nexus in irregular and sometimes conflicting ways. The best way to keep on top of these rules is to know what business activities all of your employees, contractors, salespeople, and marketing departments are conducting in each state and consult a professional for help.

If you're a retailer who participates in affiliate programs or may be affected by click-through, agency or other forms of nexus, consult with a professional CPA or tax lawyer and contact all relevant states' departments of taxation/finance to be certain of your sales tax remittance obligations.

> Nexus: A connection, tie or link. Once defined solely by physical presence, nexus can now be established when a company is considered to be "engaged in business" within a state.

Zip2Tax Customer Testimonials

We are a small online retailer and we only need sales tax for one state. It doesn't make sense for us to spend a lot on sales and use tax services. We use Volusion as our store vendor and they don't have support for all the county and city tax, so we needed to do that manually. Without your service, this would be very difficult. The way your tables break out all the specific taxes is the feature I find the most useful. And, your support has been superb!

- Doug, Focused Sales, Inc.
Tax Table Subscriber Since October 2011

Collecting The Tax

It's important to register your business properly in each state

Once you've determined that your business will be making sales that are subject to sales tax in a given state, it's time to take the next step and register with that state.

It's critical that businesses are well informed of their sales tax collecting obligations. From coast to coast, each state takes a different approach to sales tax. First of all, not all states assess sales tax, among them Montana and New Hampshire.

On the other hand, some counties or districts in a given state assess a sales tax that is separate from the state sales tax. And, just to make it a little more complicated, some cities assess their own sales tax in addition to other sales tax assessments.

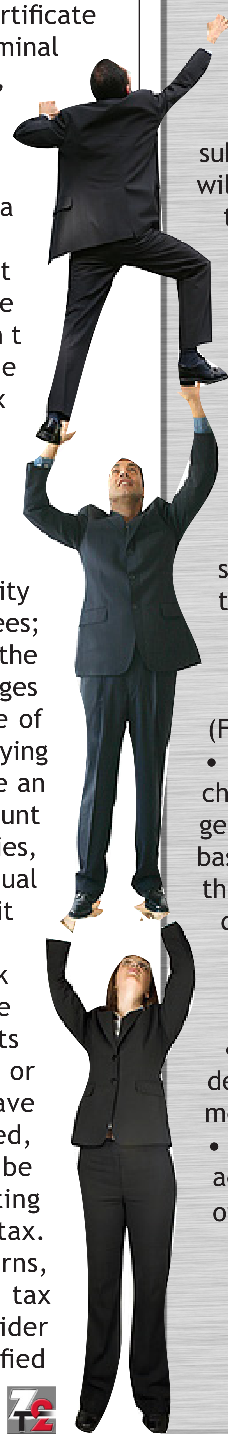
Confirm what sales taxes, if any, your business will need to collect and remit by contacting the appropriate department at the state level. The exact name of the department will vary, but the function will be essentially the same. In Florida, for example, contact the Department of Revenue; in New York state, the Department of Taxation and Finance; in Ohio, the Department of Taxation. These departments should be able to guide you through the next step, which is registering to collect and remit sales tax.

For each separate place of business that you maintain in the state, you will need to apply for and be issued a certificate of some sort that establishes your legal authority to collect sales tax from purchasers. Different states use different terminology for this certificate: it may be dubbed a license, a certificate of authority, a permit, registration or some similar term. And since collecting sales tax without this certificate is considered a criminal offense in some states, you'll want to be sure you have it before you make a single sale.

> It's critical that businesses are well informed of their sales tax collecting obligations ... Confirm what sales taxes, if any, your business will need to collect and remit ...

Different states charge different fees to issue a sales tax certificate. Nevada, for instance, requires a security deposit and permit fees; North Carolina, on the other hand, charges nothing for a Certificate of Registration and, if applying electronically, may issue an applicant his or her account number instantly. Counties, districts and individual cities may follow suit with similar procedures.

Once your paperwork (if any) has cleared the relevant departments and your certificate or account number have been issued and received, your business should be ready to begin collecting and remitting sales tax. If you have any concerns, contact the sales tax department and consider consulting with a certified public accountant or tax lawyer.



Basis: What portion of a sale is taxable?

A transaction's "taxable basis" is the value upon which applicable sales or use tax is assessed. This is not always the stated sales price of an item. The following is a list of exceptions to the "gross proceeds" rule.

- **Discounts:** When taken at the time of the sale, discounts are generally excluded from the tax base. States are split on the taxability of discounts taken after the sale - such as discounts for prompt payment.
- **Coupons and rebates:** If the coupon or rebate is issued by a manufacturer, the full price is usually subject to tax because the vendor will receive part of the payment from the customer and part from the manufacturer. If the coupon or rebate is issued from the vendor, the discounted amount is generally not taxable.
- **Trade-ins:** Most states allow the price of a trade-in to be excluded from the taxable base. Some states require the traded item to be of the same type as the purchased item.
- **Transportation charges:** In some states, charges for transport are not taxable as long as they are stated separately on the invoice. In some states, transport charges are taxable if the terms are Freight On Board (FOB) destination.
- **Labor and service:** In many states, charges for service and labor are generally not included in the taxable base if they occur after the retail sale of the item and the item's usage does not depend on services such as installation.
- **Finance and interest charges:** A retailer's charges to a consumer for the borrowing of money are not included.
- **Returns:** Most states allow for a deduction from the tax base when merchandise is returned and refunded.
- **Bad debts:** Certain uncollectable accounts receivable qualify for recovery of sales taxes previously remitted.

Common sales tax exemptions

Subsistence based: Most states offer product-specific exemptions, or lower than general tax rates, for items such as food, clothing, prescription medicines, and medical devices.

You can't make this stuff up:

Day to day items are frequently tax exempt, but the rules surrounding such items can be convoluted. For instance, in many states, a bagel purchased at a grocery store will be tax exempt, but ask the deli to slice it and *presto!* That same cold bagel magically becomes PREPARED food and is subject to tax.

Purchaser based: Under federal law, states are prohibited from taxing sales that are made to the federal government or its various agencies. Similar exemptions may exist for sales to the state and its agencies and to cities, counties, and other local jurisdictions in the state. Also common are exemptions for sales to hospitals and nonprofit charitable, religious, and educational organizations.

Use based: Purchases for certain industries the state wishes to promote (such as agriculture or manufacturing) or to encourage certain activities for the public good (such as industrial development or pollution control) may be exempt from tax or available at a reduced rate.

Items for resale: wholesale.

Occasional sales: (except in Colorado, Oklahoma and Wyoming)

zip2tax.com
Zip Code Lookup of Sales Tax Jurisdictions

Exemption Certificate Management

Document which transactions are or aren't taxable

Not everything that is sold is necessarily subject to state sales or use tax. Each state has different regulations governing what is and what is not exempt from the collection and remittance of tax. One general rule of thumb is that the purchaser is responsible for proving that their transaction is tax exempt by providing the seller with a valid certificate of exemption.

Burden of proof:

It is the responsibility of the purchaser to "prove" their transaction is tax exempt by providing a valid exemption certificate to the seller.

It is the seller's responsibility to maintain an up-to-date file of exemption certificates to "prove" to the state that any given transaction should be tax exempt.

As an example, the state of California offers full and partial sales and use tax exemptions. A partial exemption means that the qualified sale is exempt from the state general fund portion of the sales tax, but it is still subject to the statewide tax rate plus any applicable district taxes. A full exemption includes the state general fund portion of the sales and use tax, the statewide tax rate and district taxes.

To claim a sales and use tax exemption, the appropriate certificate must be obtained from the Board of Equalization (available online at http://www.boe.ca.gov/sutax/staxformsa.htm) and properly completed. A partial exemption certificate will require a description of the property that was purchased. For example, a retailer of packing equipment would describe the property on the partial exemption certificate as "packing equipment." The operator of a hardware store who sells hand tools, nuts and bolts to a qualified person for a qualified use could enter the description on the partial exemption certificate as "agricultural tools and parts for farm machinery and equipment."

An exemption certificate must be filed with the retailer, provided in a timely manner, filled out properly, and renewed regularly. This means that for exemption purposes, the exemption certificate (partial or otherwise) will be considered timely if it is taken any time:

- Before the retailer bills the purchaser for the qualified property,
- Within the retailer's normal billing or payment cycle,
- At or prior to delivery of the qualified property to the purchaser or his or her representative, or
- No later than 15 days after the date of purchase.

As each state takes a different approach to exempt sales, exemption types and information required, not to mention the various certificates and forms that may be required, be sure to consult with a professional CPA or a tax lawyer.

You've gotten permits, determined taxability, filed paperwork and collected tax, now what?

Sales Tax Returns

Different states have different sales tax return filing dates. Sales tax remittance can be required on a monthly, quarterly or other basis, often based on how much sales and use tax a business collected in the relevant reporting period.

For example, New York breaks down the filing schedule into three categories: annual, quarterly and part-quarterly (monthly). How frequently you must file sales tax returns depends on the amount of your taxable sales (and purchases subject to the use tax) or the amount of tax due.

Businesses that owe $3,000 or less in sales tax during the annual filing period, defined as March 1 through February 28 (29 in a leap year), should file an annual return.

Quarterly returns must be filed if taxable receipts, purchases subject to use tax, rents, and amusement charges are less than $300,000 during the previous quarter. (Most vendors file quarterly when they first register to collect sales tax.) The filing periods for quarterly filers are March 1 - May 31, June 1 - Aug. 31, Sept. 1 - Nov. 30 and Dec. 1 - Feb. 28 (29 in a leap year).

$300,000 of taxable receipts or more in a quarter, or a business that is legally defined as a distributor has sold a total of 100,000 gallons or more of automotive fuel (taxable or nontaxable), and a part-quarterly (monthly) return must be filed. The filing period begins with the first month of the next sales tax quarter if the business files an annual or quarterly sales tax return.

The Prompt Tax return applies, in general, if the annual sales and use tax liabilities are greater than $500,000. The filing period is monthly.

> How frequently you must file sales tax returns depends on the amount of your taxable sales (and purchases subject to the use tax) or the amount of tax due.

Even if a business does not make any taxable sales or purchases during the reporting period, sales and use tax returns must be filed by the due date.

The method of filing varies as well. While many returns can (and must) be filed electronically using the Web File feature on the New York State Department of Taxation and Finance web site, certain others, including annual filers and certain taxes on parking services in New York City, must be printed out and physically mailed to the department.

Check with a professional CPA or tax lawyer, and contact your state's tax commission or department of taxation/revenue to be sure your business is compliant and up to date.

Zip2Tax Customer Testimonials

Cost was a real issue for our company, but this subscription has a great price point! We are impressed with the uptime and the implementation ease. After we bought a subscription to Zip2Tax, we received great service. The service is virtually worry free.

- Zach, Fleapay.com, Chicago, IL
Database Interface Subscriber
Since October 2010

Thank you, thank you, thank you for providing this marvellous service! During my recent project, I relied heavily on the information that you so carefully collected ...

- Susan, Chicago, IL
Online Lookup Subscriber
Since April 2011

Who is liable?

State's laws vary as to who is liable for sales taxes. While *somebody* is always paying the tax, it is important to know who has the legal burden when it comes to lawsuit and refund issues. Most states subscribe to a couple of general approaches.

1. Seller Privilege (a.k.a. Gross Receipts, Vendor Privilege) - The seller is responsible for paying the tax. The seller has the option to "absorb" the tax in that it doesn't always have to be separately stated on the receipt.

You can't make this stuff up:

Kentucky is a seller privilege state and retailers can choose to "hide" the fact that they are paying sales tax, but this is not very viable as a marketing tool because it is illegal for retailers to advertise that they are absorbing the tax.

2. Consumer Privilege - The buyer is liable for the tax and the seller acts as an agent of the state and is responsible for collecting the tax. Because the tax is the buyer's responsibility, it must usually be stated separately on the receipt or invoice.

3. Retail Transaction - A Hybrid of #1 and #2 where the taxes are imposed on the transaction itself and the primary liability for payment falls upon both the seller and the buyer.

Resources

The Multi-State Tax Commission
www.mtc.gov

Simplifies tax regulations by creating uniform laws across most (but not all) states.

- Uniform sales and use tax exemption certificates.
- Sales/Use tax vendor registration forms.
- Multi-state joint audits.
- Dispute resolution.

Zip2Tax
www.zip2tax.com

Saves your company money and effort by providing reliable sales and use tax rates for every jurisdiction in the U.S. and Canada via manual lookup, database interface, or .CSV tables.

We also provide a list of phone numbers for every state's tax agency: http://www.zip2tax.com/z2t_faq.asp#states

You can't make this stuff up:

Streamlined Sales Tax Project

Created to help states collect unpaid sales and use taxes, this commission offers full service tax reporting, filing services, and limited tax amnesty free of cost to registrants. But be aware: registering with the SSTA is not without its hazards. These free tax services take control out of your hands. They may establish nexus for you and remit taxes that you do not agree with. Your business might find itself paying a LOT more in sales and use taxes.

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866-492-8494

Audit Defence

Best practices to help you survive an audit

States have been under enormous pressure to balance budgets without raising taxes. As a result, states have been increasing the number of audits they perform, both randomly and by fishing for them by looking at other audited company's books. They're using every high-tech method available to examine each and every penny.

Keep in mind that this audit-your-way-to-fiscal-balance method works very well, but it has made it necessary to hire many new and inexperienced auditors. Some of these hires have very little training and are often learning while on the job.

While audits can be somewhat less enjoyable than passing a kidney stone, there are some simple steps you can take to help get you through the pain.

Schedule the audit to begin on a date when you will have adequate manpower available to assist the auditor by providing documentation and answering questions.

Make sure you have a sales tax/accounting manual and that your procedures show regular updates have been occurring.

Review your documentation to make sure it is up to date and orderly, including:

- Sales figures
- Accounts payable
- Exemption certificates
- Purchases, including out-of-state
- Ledgers, journals, and adjustments
- Filed returns
- Credits and claims for refunds

Treat the auditor as a professional with appropriate courtesy. Provide them with adequate working conditions.

Be consistent with your answers. Do NOT lie.

Convince the auditor that you are confident in your compliance. Keep in mind that you know a lot more about how your business operates than the auditor does.

Watch for overpayments.

Be prepared to get professional help.

Be prepared to negotiate.

Remember, audits don't need to create chaos. By being prepared, you'll get through it, I promise. Just smile, play nice, and stock up on Alka-Seltzer.

And when it's over, if you feel the need for a little passive-aggressive payback, you can always thank your auditor with a coupon for 5% off their next purchase from your establishment with a one day expiration date.

Disclaimer: This whitepaper is intended for education and entertainment only and is not intended as legal advice. Tax laws can vary significantly depending on the type of business, product, location, and other factors not fully explored here. Always consult a qualified attorney, CPA or tax adviser who is an expert in sales and use tax law for your area before making business decisions.