5 STEPS TO MANAGING SALES TAX COMPLIANCE FOR EXEMPT SELLERS

Stay compliant even when tax gets complicated

Avalara
Tax compliance done right

Contents

DISCLAIMER

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

Introduction

In theory, sales tax compliance should be a basic business task – a checkbox on a long list of must-dos. In reality, it's tedious, time-consuming, and (often) mind-bogglingly complicated, especially when you factor in exempt sales.

Businesses need technology to stay on top of tax compliance. Automating sales tax compliance and exemption certificate management with software specifically designed to handle this work for you is a cost-effective solution; according to a commissioned Total Economic Impact™ study conducted by Forrester Consulting on behalf of Avalara, ensuring tax exemption certificates are completed properly eliminated 416 hours of work each year and reduced administrative time to validate certificates resulting in a three-

year savings of over $96,000 for the study's composite organization. You can also save your team the time and hassle of manually inputting customer data and tracking down documents, not to mention automation can minimize the risk that comes along with human error.

Exemption certificate management can be complicated, but finding the right tax solution fit for your business doesn't have to be. It all starts with having a complete picture of compliance.

THE FIVE STEPS TO MANAGING SALES TAX FOR EXEMPT SELLERS

Step 1.
Be clear on your tax obligations and register your business

Step 2.
Determine which sales and which customers qualify as exempt

Step 3.
Collect exemption certificates

Step 4.
Validate exemption certificates

Step 5.
Store, track, and manage documents and records

Step 1: Be clear on your tax obligations and register your business

WHY THIS STEP IS IMPORTANT

Knowing where you need to collect and remit sales tax is the first step in staying compliant. You might not need to register everywhere, so determining where your business has economic nexus (the connection that establishes a business obligation to register, collect, and remit tax or, in the case of exemptions, file a $0 return) is key. First, you need to understand which business activities can establish a nexus connection, then determine where you might have tax obligations.

WHERE PROBLEMS CAN OCCUR

Many business activities can create a nexus obligation with a tax jurisdiction, including having physical locations, remote employees, affiliate relationships, or economic activity in that tax jurisdiction. Small shifts in your business could be the tipping point to nexus in more states. As changes happen, tax obligations and registration requirements can change too, often without you realizing it.

For businesses with exempt sales, economic nexus can be particularly confusing because it's established by reaching a threshold based on an amount of sales and/or a certain number of transactions. It can be tricky to determine whether exempt sales should be included in those thresholds, and each state handles exempt sales differently.

You'll find out quickly that the processes, forms, and requirements to register your business differ from state to state (and sometimes jurisdictions within a state), so there's no simple way to manually register. And getting it wrong or operating without a business license can be a costly mistake.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Relying solely on people resources (internal or outsourced) to track and manage nexus simply isn't efficient. You can't expect (or afford) them to be experts on every state's tax rules, regulations, and thresholds, or to constantly monitor when your company's sales could trigger nexus in a new state. But you can arm them with technology that will do all that – and more. Plus a cloud-based license management solution that can register you to collect and remit sales tax, obtain the licenses you need, and manage your license portfolio in one place.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara AvaTax: Tracks sales activity and sends alerts when you're approaching nexus thresholds
- Avalara Business Licenses: Reduces the complexity of managing license requirements

ADDITIONAL RESOURCES TO CONSIDER

- Sales tax risk assessment: Assess where you might have tax obligations
- Know Your Nexus: Understand the various ways nexus can be established and determine where and when you need to collect and remit sales tax
- State-by-state exemption certificate guide: Learn what's involved with registering in new jurisdictions to collect and remit sales tax
- Sales tax permits: A state-by-state guide: Get individual state requirements for sales tax permits, including when you need a permit and how to go about getting one
- U.S. sales tax exemptions 101: Find out what you need to know to sell into the United States from the EU or elsewhere
- Avalara License Guidance: Determine which business licenses your business requires

Step 2: Determine which sales and which customers qualify as exempt

WHY THIS STEP IS IMPORTANT

After you determine where you have nexus and register to collect and remit sales tax in the appropriate jurisdictions, you need to assess which of your sales and/or customers qualify as exempt from sales tax. There are many reasons sales can be exempt from sales tax, including how or where the goods are used by the buyer. One of the most common reasons for a sales tax exemption is when items are intended for resale.

WHERE PROBLEMS CAN OCCUR

Rules are different in each state; some states don't tax services and labor (and therefore don't require any documentation), but some do. Plus, many states exempt nonprofits and government agencies from paying sales tax, but they're still required to provide a valid exemption certificate.

As the number and types of products or services you sell grows, so does the likelihood you'll have more tax-exempt sales and more complexity in maintaining compliance. New laws and regulations for remote sellers are increasing the number of customers you must monitor and manage

when it comes to exempt sales. These new customers may create an obligation to collect exemption certificates in a jurisdiction where you previously weren't required to. If that happens, you either need to start charging sales tax to customers or obtain a valid exemption certificate.

In addition, supply chain relationships can trigger a sales tax obligation even if no sales tax is collected. When this happens, you might not have to collect tax, but you need to have a valid resale or exemption certificate for your records. If you can't produce valid documentation in the event of an audit, you could be liable for paying tax as well as interest and possibly penalties.

WHAT AUTOMATION OFFERS YOUR BUSINESS

An automated solution can allow customers to upload their exemption certificates or submit their information to generate new ones. Plus Avalara Exemption Certificate Management validates certificates and applies exemptions automatically at the point of sale, so you won't have to worry about chasing down documents from your customers or applying tax to an exempt sale on accident.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara Exemption Certificate Management: Makes sales tax exemption management and collection easier

ADDITIONAL RESOURCES TO CONSIDER

- Drop shipping and sales tax compliance: Learn about drop shipping and how it impacts your tax liability
- What is product taxability and why does it matter?: See how product taxability impacts your goods and services and what you need to do to stay compliant

WHAT CAN AFFECT NEXUS

- Physical location
- Warehouse inventory
- Remote employees
- Affiliate relationships
- Ecommerce and marketplace sales
- Tax-exempt customers and sales

Step 3: Collect exemption certificates

WHY THIS STEP IS IMPORTANT

Once you decide to accept the transaction as exempt, you must collect a valid exemption certificate. To document your exempt sales, you need to collect the right exemption certificates, check that the information is accurate and complete, and file them with the transaction information so you can easily track and retrieve that information later. You'll also need to keep track of when certificates expire or need to be renewed, and you'll have to do this for every state or jurisdiction where you have exempt sales and tax-exempt customers.

Make sure you understand the certificates and specific forms necessary for different jurisdictions and exemptions. Decide whether you'll collect certificates from customers up front or at the time of sale. You should also determine whether you have any customers that have been purchasing tax exempt without a certificate on file, so you can back collect exemption certificates for those customers.

WHERE PROBLEMS CAN OCCUR

Some states have specific requirements when it comes to the documentation needed for exemptions while others are more flexible. With more than 13,000 sales and use tax jurisdictions in the United States, each with varying tax rates and product taxability rules, it can be difficult to know when you're not required to collect sales tax.

WHAT AUTOMATION OFFERS YOUR BUSINESS

There are many different certificates, and knowing which is the correct one to use can be challenging. But collecting the right one can help improve cash flow by not delaying the sale and improve customer experience by making it an easy process. If you as a seller have an online purchasing solution for your customers, you may want to integrate automated sales tax exemption certificate management software.

WHICH SOLUTIONS ADDRESS THIS STEP

- <u>Avalara Exemption Certificate Management</u>: Makes it easier to collect and manage exemption certificates

ADDITIONAL RESOURCES TO CONSIDER

- <u>Avalara Tax Research</u>: Find answers to your trickiest tax questions quickly and easily
- <u>State-by-state exemption certificate guide</u>: Find the exemption certificate requirements you need to stay compliant for every state

Step 4: Validate exemption certificates

WHY THIS STEP IS IMPORTANT

If your business has exempt sales, make sure you have a sound sales and compliance process as well as resources in place to validate exemption certificates at the time of sale. Successfully collecting exemption certificates is a lost cause if they aren't properly validated and filled out. Be sure you understand the information required for each type of certificate, have a process in place to help you easily identify missing or incorrect information, and follow up if necessary.

When confirming the accuracy of an exemption certificate, you'd need to check for the following:

- The name and address are consistent with the company name and address on the invoice
- There's a comprehensive description of the items purchased
- The certificate is complete

Finally, the certificate may require the signature of the purchaser or agent and date of completion, since some certificates expire in certain jurisdictions.

WHERE PROBLEMS CAN OCCUR

Regardless of the reason for an exemption, the seller must collect and verify a complete certificate for each tax-exempt buyer to document why sales tax wasn't collected. Failure to produce valid documentation can be problematic to your business if you're audited. The inability to produce valid documentation is a common reason for businesses to be assessed tax, interest, and penalties during an audit. Properly managing sales tax exemption certificates can help you be better prepared and able to show compliance.

WHAT AUTOMATION OFFERS YOUR BUSINESS

- Avalara Exemption Certificate Management: Makes sales tax exemption certificate management and collection easier

ADDITIONAL RESOURCES TO CONSIDER

- Mission possible: Exemption certificate compliance: Learn more about the three main components of the exemption certificate management process and the challenges involved with each

- Exemption certificate management: Watch this video to learn how you can easily import all the certificates you already have,

request new certificates either one at a time or all at once, and collect certificates on your ecommerce site with software that simplifies the process for you

AVALARA EXEMPTION CERTIFICATE MANAGEMENT MAKES IT EASY TO:

- Apply exemptions and collect certificates at the point of sale, creating a better customer purchasing experience

- Identify, auto-validate, and verify the accuracy of exemption certificates, reducing the likelihood of incomplete or incorrect information

- Collect, track, and manage sales tax exemption certificates and tax documents to satisfy compliance requirements, saving time and reducing risk

- Avoid tax calculation errors that can result in rebilling and delayed orders

- Be audit-ready with on-demand reporting and easy access to sales data and documents, which are up to date and stored in a secure, central location

Step 5: Store, track, and manage documents and records

WHY THIS STEP IS IMPORTANT

After you've identified your exempt customers and collected certificates, you'll need to consider how to maintain tax-exempt transaction records, which can take a significant amount of time and resources. Sales tax exemption certificate management is not a set-it-and-forget-it process. As new customers come on board, you must repeat the process to check their qualifications and confirm the information on each form is complete. For some states, validated exemption certificates never expire, but you need to make sure they're signed by an authorized signer. In other states, like Florida, resale certificates expire annually and must be renewed. All of these variations make it difficult to keep your certificate program current and to manage it over time.

WHERE PROBLEMS CAN OCCUR

To successfully handle exempt sales, you need an efficient way to collect, store, manage, and renew exemption certificates at scale. Many businesses do this process manually, which can be time-consuming as well as risky. Paper documents in filing cabinets can easily get misplaced, misfiled, or forgotten, which makes proving compliance much more difficult. Auditing exemption sales is part

of sales and use tax audits, and missing or expired exemption certificates can result in penalties assessed during an audit.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Moving this process to the cloud and automating it with a solution like Avalara Exemption Certificate Management alleviates many of these worries, keeping you organized, up to date, and on track with tax compliance.

WHICH SOLUTIONS ADDRESS THIS STEP

- Avalara Exemption Certificate Management: Makes it easier to collect and manage exemption certificates

ADDITIONAL RESOURCES TO CONSIDER

- Automating exemption certificate management: Store, collect, and provide reports for exemption certificates

MORE EASILY MANAGE EXEMPT SALES WITH AVALARA

Avalara takes the complicated, detailed, time-consuming, and time-sensitive steps involved with managing sales tax exemption certificates and automates them into one simple, streamlined, digital process that syncs with your financial systems and business processes.

Continued
AVALARA EXEMPTION CERTIFICATE MANAGEMENT MAKES IT EASY TO:

- Monitor and get alerts about changes to your sales tax obligations so you can stay knowledgeable about compliance requirements

- Manage all your sales transactions (taxable and exempt) in one place for greater visibility into your business

- Add exempt sales management to your existing ERP, CRM, and billing systems with prebuilt integrations to most platforms

- Identify taxable and nontaxable sales and identify the right certificates with Avalara Tax Research

Are you ready to simplify sales tax exemption certificate management? Talk to one of our tax automation experts about Avalara Exemption Certificate Management and let us help you find the right solution for your business.

Avalara

A complete tax compliance solution built for how you do business

At Avalara, we live and breathe tax compliance. That means that we have solutions to help you determine nexus obligations, register, calculate sales tax, manage exempt sales, and file and remit your returns – saving you time and hassle.

Avalara makes tax compliance faster, easier, more accurate, and more reliable for 41,000+ business and government customers in over 75 countries. Tax compliance automation software solutions from Avalara leverage 1,200+ signed partner integrations across leading ecommerce, ERP, and other billing systems to power tax calculations, document management, tax return filing, and tax content access. Visit **avalara.com** to improve your compliance journey.

Learn about the Avalara suite of products that can help simplify compliance

Avalara AvaTax
Apply sales and use tax calculations

Avalara Business Licenses
Manage licenses in a secure database

Avalara Cross-Border
Streamline international compliance, classify tariff codes, and register for VAT

Avalara Exemption Certificate Management
Collect, store, and manage documents

Avalara Returns
Prepare, file, and remit sales tax returns

Avalara Tax Research
Get tax research in plain language