

The background features a dark blue gradient with several light blue curved lines and circles. On the left, there is a stylized bar chart with five bars of varying heights, each topped with a semi-circle. A large white number '5' is positioned in the center, partially overlapping a blue circle and a white semi-circle. Below the '5' is a small orange triangle.

5 STEPS TO MANAGING SALES TAX FOR SELLING SERVICES

Understanding taxability and sales tax compliance for service-based businesses

Contents

DISCLAIMER

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	3	GO
STEP 1: BE CLEAR ON YOUR TAX OBLIGATIONS AND REGISTER YOUR BUSINESS	4	GO
STEP 2: DETERMINE SERVICE TAXABILITY AND SALES TAX RATES	6	GO
STEP 3: COLLECT AND VALIDATE EXEMPTION CERTIFICATES	8	GO
STEP 4: CALCULATE SALES TAX	10	GO
STEP 5: REMIT SALES TAX AND FILE RETURNS	11	GO
AVALARA SUITE OF TAX SOLUTIONS	12	GO

Introduction

The digital world blurs the line between products and services; is an ebook a tangible product, or is the ability to download it a service? What about software as a service (SaaS)? Are services taxable? Each state has their own rules and regulations determining the taxability of software and services.

Navigating sales tax compliance for a service business can get complex: bundling goods and services into one fee, understanding different state sourcing rules (origin-based vs. destination-based), and recognizing how tax-exempt sales impact your filing obligations and nexus thresholds.

Simply put, there is no way to stay on top of tax compliance without technology. Automating sales tax management with software specifically designed to handle this work for you is a cost-effective solution; according to an Avalara/Potentiate survey, businesses with 20–499 employees estimate spending [an average of \\$1,740 per month identifying state sales tax obligations and filing requirements](#). You can also save your team the time and hassle of manually researching tax changes and updating spreadsheets, not to mention automation can minimize the risk that comes along with human error.

To help you navigate the complexities of sales tax compliance, we outlined five essential steps that every service-based business should follow. These steps will guide you through the process of ensuring compliance, reducing risk, and optimizing your tax management strategy.

THE FIVE STEPS TO MANAGING SALES TAX FOR SELLING SERVICES

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

Step 2. Determine service taxability and sales tax rates

Step 3. Collect and validate exemption certificates

Step 4. Calculate sales tax

Step 5. Remit sales tax and file returns

Step 1:

Be clear on your tax obligations and register your business

WHY THIS STEP IS IMPORTANT

Sales tax compliance starts with [nexus](#): knowing where you need to collect and remit sales tax based on your business activities within a state or tax jurisdiction. It's key to understand where you have nexus now, and also where you could trigger it in the future. You should also be clear on whether you have sales tax obligations based on [physical presence nexus](#), [economic nexus](#), or both.

Understanding where and how you need to register and which business licenses, forms, and registrations you need to complete before you can begin to collect and remit sales tax on services is tedious, but key. It's actually illegal to collect sales tax in most states until your business is properly registered; so it's important to know where you owe and register to collect and remit

taxes to avoid fines or risk having to cease operations.

Physical presence nexus sounds straightforward – your business owes sales tax where you have a physical presence – but it can trip up service business owners. If your business is based in one state but you do a job or hire employees to work in another state, you now have nexus in the new state. For example, if you own a house cleaning company in North Carolina and employ cleaners throughout the southeast, you'll have tax obligations in several new states.

In the U.S. there's no one standard for nexus, every state sets its own rules and thresholds. And these can be vastly different based on where you sell, what you sell, and who you sell to – particularly if ecommerce and marketplaces are part of your sales strategy. Certain states may also include exempt sales in their [economic nexus thresholds](#), which means you could still need to file a \$0 tax return, even if you don't collect tax.

For example, Georgia's nexus threshold is \$100,000 in revenue or 200 transactions on the sale of taxable goods, which includes exempt sales of taxable goods, but excludes taxable services, exempt services, and exempt sales for resale. Whereas Mississippi's economic nexus threshold is \$250,000 in revenue (no provision for number of

transactions) and includes taxable goods, taxable services, exempt sales, and exempt services. In Alabama, the economic nexus threshold is also \$250,000 in sales only, which includes tax-exempt sales and also sales made through a non-collecting marketplace but excludes sales made through a registered marketplace facilitator, exempt wholesale sales, and exempt services.

WHERE PROBLEMS CAN OCCUR

As your business changes, your tax obligations will likely change too. And if you aren't accounting for those changes, you could run into trouble with tax authorities or auditors. Small shifts in your business – such as an influx of new customers – could be the tipping point to nexus in more states. It's a lot to manage and changes happen frequently. These changes can inadvertently cause errors and oversights, which could prove costly to your business.

Sourcing rules are another potential pitfall for service businesses. States use two different sourcing rules to determine sales tax on services: benefits received and services performed. Issues can arise when a transaction occurs in a services-performed state for a customer located in a benefits-received state, and sales tax could be collected twice.

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.

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](#): Choose from basic and full assessments depending on your needs
- [Know Your Nexus](#): Understand the various ways nexus can be established and determine where and when you need to collect and remit sales tax

- [Sales tax registration 101](#): Learn what's involved with registering in new jurisdictions to collect and remit sales tax
- [Sales tax permits](#): Get individual state requirements for sales tax permits, including when you need a permit and how to go about getting one
- [Avalara License Guidance](#): Determine which business licenses your business requires
- [What you need to know about destination and origin sourcing of sales tax](#): Find out how sourcing affects your sales tax obligations

WHAT CAN AFFECT NEXUS:

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



Step 2: Determine service taxability and sales tax rates

WHY THIS STEP IS IMPORTANT

It's imperative that you know the taxability of the goods or services that you buy, sell, and use. Not all products are taxed the same way across jurisdictions, and even within jurisdictions rates and rules can get complicated. You can save time spent looking up tax laws and changes with a reliable research engine like Avalara Tax Research.

Software taxability is also tricky; sales tax rules for software and software as a service vary from state to state. And oftentimes state laws don't keep up with changes in technology. Get the download in our latest [state-by-state guide to the taxability of digital products](#).

WHERE PROBLEMS CAN OCCUR

With so many different tax rates and taxability rules to keep track of, it's easy to make mistakes. What's taxed at one rate in one state may be taxed at another rate in a different state or even in another jurisdiction within the same state. In some states, those same products or services could be tax-exempt or partially taxed. You should also be aware of whether [services are taxable in your jurisdiction at all](#).

Who you sell to and how you sell it can also impact taxability. If you have tax-exempt customers, you need to consider how you're tracking, managing, and storing exemption certificates. Failure to produce accurate records can result in noncompliance and fines if you're audited.

It's not uncommon for companies like yours to provide a mix of goods and services. Bundling these into one offer may be convenient, but it can complicate taxability as well as tax rates. If you combine goods and taxable services on an invoice, the state could potentially view the entire transaction as taxable, even if part of the transaction is exempt.

WHAT AUTOMATION OFFERS YOUR BUSINESS

The inconstant nature of sales tax on services makes compliance onerous. Which is why so many businesses now employ technology to do this work. Automation can help identify taxability for products and services for you, saving time and improving accuracy to help you ensure that you're taxing services appropriately. Plus, Avalara software comes with a powerful tax engine and vast tax content library with regularly updated tax rates and taxability rules. Tax automation with Avalara also helps you monitor changes to taxability, track and store exemption certificates, and keep tidy records in the event of an audit.

WHICH SOLUTIONS ADDRESS THIS STEP

- [Avalara Exemption Certificate Management](#): Makes sales tax exemption management and collection easier
- [Avalara Tax Research](#): Find answers to your trickiest tax questions quickly and easily

ADDITIONAL RESOURCES TO CONSIDER

- [What happens if I buy tax-exempt products then use them for my business?](#): Get the lowdown on use tax; even if you don't pay sales tax when you buy an item, you may still be on the hook for use tax
- [When should I collect sales tax on my services?](#): Learn when you should collect sales tax on services provided and how the rules differ between states
- [U.S. sales tax exemptions 101](#): Find out what you need to know to sell into the United States from the EU or elsewhere



SIX TYPES OF SERVICES (AND EXAMPLES OF EACH):

- 1 Services to tangible personal property: car repairs
- 2 Services to real property: landscaping and janitorial work
- 3 Business services: telephone answering services and extermination services
- 4 Personal services: tanning salons and animal grooming
- 5 Professional services: provided by attorneys and physicians
- 6 Amusement/Recreation: admissions to entertainment events and amusement parks

Step 3: Collect and validate exemption certificates

WHY THIS STEP IS IMPORTANT

Understanding how your tax-exempt sales or customers might impact your tax obligation is essential to compliance, especially when it comes to selling services. Once you accept a transaction as exempt, you must collect the correct exemption certificate, check that the information is accurate and complete, and file it with the transaction information so you can easily track and retrieve the information later. You'll also need to keep track of when certificates expire or need to be renewed.

WHERE PROBLEMS CAN OCCUR

Just because a sale is tax-exempt doesn't mean it is exempt from hassle. Even an exempt sale can count toward your sales tax nexus threshold in some states.

And, there are states with specific requirements when it comes to 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.

Regardless of a 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, and it 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.

Service taxability is complex, and it gets even trickier when you add exemption certificate management. It's important that you know which states exempt services from sales tax, which services are exempt, and to stay up to date on changes that states make to their policies.

When a company exceeds the threshold of annual sales revenue or the number of transactions set by the state, it is required to register for sales tax.

Economic nexus affects remote sellers who sell goods and services in a state where they do not have a physical presence.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Automation can help simplify and streamline how you collect, validate, and manage your exemption certificates, which can save you and your team the time it takes to collect and maintain exemption certificate validity and help you avoid the risk of human error.

WHICH SOLUTIONS ADDRESS THIS STEP

- [Avalara Exemption Certificate Management](#): Makes sales tax exemption management and collection easier
- [Avalara Tax Research](#): Find answers to your trickiest tax questions quickly and easily

ADDITIONAL RESOURCES TO CONSIDER

- [What happens if I buy tax-exempt products then use them for my business?](#): Get the lowdown on use tax; even if you don't pay sales tax when you buy an item, you may still be on the hook for use tax
- [What you need to know about destination and origin sourcing of sales tax](#): Learn the difference between sourcing rules
- [When should I collect sales tax on my services?](#): Learn when you should collect sales tax on services provided and how the rules differ between states

HOW ARE SERVICES SOLD ON MARKETPLACES TAXED?

Services sold on marketplaces are taxed the same as those sold elsewhere.

You should, however, be aware of a set of laws called [marketplace facilitator laws](#) that require marketplaces like Amazon, Etsy, and Walmart to collect sales tax on behalf of a seller.



Step 4: Calculate sales tax

WHY THIS STEP IS IMPORTANT

Get your calculator ready – it's time to calculate sales tax! Depending on the types of services your business deals with and where you sell into, you could be determining rates and calculating sales tax for a while.

You should understand which variables make up a tax rate, like tax jurisdictions and product taxability, and then put a plan in place to monitor and apply the most up-to-date tax rates on your transactions. Failure to calculate the correct tax can result in you overcharging or undercharging your customers, and having to answer for the difference in penalties.

If your company sells something that is a combination of goods and services, like furniture and someone to come out and assemble the furniture, or like a hair salon that provides cuts and styling but also sells products, taxability can get complex. The service might be tax free, but in states like

California, [the products would likely require sales tax](#).

WHERE PROBLEMS CAN OCCUR

If your buyers are in another state, their tax rates are likely different from yours. Ecommerce sales charge the tax rate based on where the items are shipped to, not where they're shipped from, and many states, like California, Ohio, and Pennsylvania, follow the same sourcing rules. [Other states have different sourcing rules](#); in New Mexico, for instance, services that require an advanced degree or a license are sourced to the seller's place of business.

Services are taxed differently based on the type of service. Car detailing is going to be taxed at a different rate than attorney services, for example. Make sure you know the taxability laws in your state as it applies to your business.

WHAT AUTOMATION OFFERS YOUR BUSINESS

No more downloading rate tables or combing through state websites. With automated tax calculation, tax rates are instantly applied to every transaction, taking into consideration item taxability rules and exemptions. Get alerts when you're at or about to exceed nexus thresholds. Address validation

software pinpoints where the sale originated and applies the relevant tax amounts at checkout. The efficiency that automation enables makes multistate sellers and cross-border sales much easier to get right, resulting in more accurate calculations and happier customers.

WHICH SOLUTIONS ADDRESS THIS STEP

- [Avalara AvaTax](#): Calculates sales tax across industries, borders, and tax types

ADDITIONAL RESOURCES TO CONSIDER

- [Avalara Tax Research](#): Provides answers to your trickiest tax questions quickly and easily

BUNDLING. Bundling can create complications for sales tax on services. Remember, the varying rates between goods and services can trip you up when they're bundled together, and states might tax the entire transaction, even if the purchase is partially exempt. It's important that you know the taxability rules that apply to everything you sell.

Step 5:

Remit sales tax and file returns

WHY THIS STEP IS IMPORTANT

So you've determined your nexus obligations and taxability, registered to collect and remit tax in the appropriate jurisdictions, and created a detailed calendar of [state sales tax holidays](#). Now it's time to remit sales tax and file returns.

Each tax authority has their own regulations and forms around sales tax remittance, including due dates, format (paper or electronic filing, which is becoming increasingly popular), and frequency. In most states, you should remit taxes to a state agency that then distributes the tax dollars to local agencies. But in some states, like Alabama, Colorado, and Louisiana, you'll have to register and file with those local agencies too.

WHERE PROBLEMS CAN OCCUR

You may have multiple deadlines to track, with different filing requirements for each jurisdiction. Failure to remit taxes on time can result in fines, late payment fees, and penalties.

WHAT AUTOMATION OFFERS YOUR BUSINESS

Making sure you understand the filing requirements for each jurisdiction where you collect tax and have a plan to file those returns when they're due can be a time-consuming and labor-intensive process. An automated solution can keep track of due dates and file for you, and even track economic nexus.

WHICH SOLUTIONS ADDRESS THIS STEP

- [Avalara Returns](#): Automates sales tax returns, including preparation, filing, and remittance

ADDITIONAL RESOURCES TO CONSIDER

- [Streamlined Sales Tax](#): Covers the cost of using a tax compliance solution like Avalara in some states and for qualified businesses

ZERO RETURN. Your business may be required to file a zero return (also known as a \$0 return) even if you don't have any taxable sales to report during a filing period, including tax-exempt sales where sales tax wasn't collected if those sales were made in states that include exempt sales in their [economic nexus thresholds](#).

AVALARA CAN HELP

A lot goes into getting (or staying) tax compliant when you're selling services. From changing legislation to tricky taxation scenarios to different regulations across states, it can quickly become overwhelming. But if you have the right tools and resources, it doesn't have to be.

- [Know Your Nexus ebook](#)
- [Nexus resource hub](#)
- [Sales tax registration 101](#)
- [Business licenses 101](#)
- [Sales tax laws by state](#)
- [Sales tax calculator and tax rate lookup tool](#)
- [5 steps to managing sales tax compliance for exempt sellers](#)
- [How to manage exempt online sales](#)



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 on services, manage exempt sales, and file and remit your returns – saving you time and hassle.

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