



NAVIGATING USE TAX:

Industry insights for smarter compliance



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DISCLAIMER

Tax rates, rules, and regulations change frequently. We hope you find this information helpful; however, this resource is for informational purposes only and does not provide legal or tax advice.

Why use tax deserves a closer look

You collected sales tax. You paid the vendor invoice. You filed your sales and use tax returns. But are you sure you're compliant?

Consumer use tax is an often-misunderstood area of tax compliance. More than half of respondents to a [2024 survey by Censuswide and Avalara](#) said use tax rules and rates are complex and pose a significant challenge to their business. Use tax compliance can be even trickier depending on your industry.

With state auditors homing in on use tax compliance, you can't afford to risk getting it wrong.

This guide gives an overview of how your industry may be impacted and best practices for meeting your consumer use tax obligations.

What is consumer use tax?

Every state with a sales tax also has a use tax. There are key differences between the two tax types, particularly who pays the tax. Understanding the [differences between sales tax and use tax](#) is essential to maintaining compliance.

When your business purchases, stores, or uses taxable goods or services without paying sales tax, you may be liable for consumer use tax. You may also owe consumer use tax if you underpaid sales tax. (Businesses may also be overcharged sales tax, which must be corrected with the vendor or by filing a refund claim with the state.)

Many reasons can trigger a use tax obligation. It ultimately comes down to vendor practices or internally driven reasons stemming from how you conduct business.



For example:

- A vendor or supplier wasn't required to charge sales tax in the state where they shipped products or provided a service for your business.
- Your business consumed taxable goods or services that your company bought tax-free.
- Your business has a centralized purchasing location but your purchases are distributed to multiple locations.
- A vendor or supplier calculated the wrong sales tax rate.
- A vendor applied an incorrect exemption on your purchase.

Alaska, Delaware, Montana, New Hampshire, and Oregon don't have a state sales tax. If your company buys goods in one of those states then uses them in a state that does have sales tax, you may owe use tax on the original or fair market value. Your business must also reconcile any sales tax you already paid against use tax owed.

Whereas sellers collect sales tax from buyers and remit it to state tax authorities, businesses must self-assess consumer use tax. You must figure out how much consumer use tax is due then report use tax on your sales and use tax returns.

Some industries are more impacted by use tax than others because of the nature of how they operate.



Consumer use tax challenges faced by key industries

Some industries face greater risk of use tax noncompliance due to the complexity of their purchasing and tax scenarios. Manufacturers often deal with mixed-use purchases and varying exemptions on raw materials, supplies, and capital equipment. Construction companies face challenges tracking taxability across job sites, projects, and jurisdictions, especially when working with subcontractors. Retailers manage a wide range of suppliers and often deal with tax implications tied to free giveaways and samples.

If you work in any of these industries, it's particularly important to keep use tax compliance in check.

Manufacturing

Manufacturers frequently purchase raw materials, equipment, and machinery. Some of these items qualify for sales tax exemptions when used directly in production. Items that are used indirectly and aren't part of the final product may be taxable.

Determining whether an item qualifies for a production-related exemption can be difficult because states have different definitions of direct use and indirect use. For example, a conveyor might be considered part of the manufacturing process in one state. Another state may decide the conveyor is used for shipping and either consider it taxable or not. Similarly, a forklift used predominately in the production cycle may be exempt from sales tax, but another forklift that is used mostly for unloading raw materials that are put into storage may not qualify.

Managing inventory is an area that can trip manufacturers up. It's common for them to buy materials used in production for resale but later use them internally, requiring self-assessment



Compliance checkpoint

Implement an inventory tracking system and stay current on state and local taxability rules. Conducting tax research is especially important to help you identify which rules apply to your situation. Together, these strategies can help flag use tax obligations before they become audit issues.



of use tax. Let's say your business buys sheet metal tax-free, expecting it to be used in customer products. Due to supply chain delays, you divert some of the sheet metal to repair your own machinery. Depending on your state's regulations, you may need to self-assess and remit use tax on the sheet metal.

Construction

Use tax compliance in the construction industry is complex because taxability depends on how and where materials are used – whether they're consumed during a job, incorporated into real property, or resold. Factors like contract type (lump sum vs. time and materials), project ownership (private vs. exempt entities), and varying state and local rules add further complications.

Construction companies often have work underway in multiple tax jurisdictions. When building a street, bridge, or pipeline that crosses state lines, a business may have to comply with different tax rules in each jurisdiction.

Moving heavy equipment such as a crane or bulldozer or supplies such as steel or asphalt from one state to another may trigger an obligation for your company to pay use tax.

The case of [Ellingson Drainage, Inc. v. South Dakota Department of Revenue](#) demonstrates why businesses need to consider consumer use tax when transporting materials. The South Dakota Department of Revenue audited Ellingson and concluded the Minnesota-based construction company owed \$75,555 for equipment it used in South Dakota – some of which was used in the state for only one day. Ellingson argued that the unapportioned use tax was unfairly disproportionate to the extent of the equipment's usage in the state. The [South Dakota Supreme Court](#) upheld the assessment. Ellingson then appealed to the U.S. Supreme Court, which declined to review the decision.

Compliance checkpoint

Implement systems to monitor job site activity. Track where and how you use materials and equipment to help determine whether you have use tax obligations.

Retail and ecommerce

Retailers can be on the hook for consumer use tax when they use items for store operations, marketing, or promotions.

A retailer may owe use tax if employees use merchandise such as office supplies that were intended to be sold.

Retail businesses need to be especially careful about reviewing purchases when running marketing campaigns or store promotions. Any giveaways, advertising inserts, display racks, or signage centrally purchased and shipped across state lines may trigger unexpected use tax liabilities.

For example, a clothing retailer in Oregon (a state with no sales tax) that ships promotional materials it bought tax-free to its California and Washington stores would need to calculate and remit use tax to those states.

Giveaways such as promotional swag, branded merchandise, product samples, or gifts for customers and influencers can trigger unexpected use tax liabilities. These items are often purchased under a resale certificate (since they resemble inventory). But once they're given away for free, the resale exemption no longer applies. The business becomes the end user and is generally required to self-assess and remit use tax.

This risk is especially high when items are distributed across multiple states or purchased from vendors that didn't charge sales tax. Because promotional gifts are frequently sourced by marketing teams or social media managers outside the usual procurement workflow, they're a common blind spot in audits.



Compliance checkpoint

Keep detailed purchase records to help accurately calculate use tax liabilities and aid in audit readiness. Without a clear trail of where and how promotional items were used, businesses risk noncompliance.

Compliance checkpoint

To reduce compliance risk, medical facilities should clearly track the intended use of purchased equipment and train staff to report any non-qualifying uses. Establishing internal procedures to monitor usage helps surface potential use tax liabilities before they become audit issues.

Health care

Hospitals and medical facilities often purchase tax-exempt items, either because the item qualifies for a product-specific exemption or because the facility holds an exempt organization status. However, whether an item is exempt depends on both what is purchased and how it will be used.

For example, items such as wheelchairs, crutches, canes, and walkers may be considered exempt durable medical equipment (DME) when purchased by an individual for personal medical use. However, the same items may be subject to tax when purchased by a hospital, even if they are used for medical purposes within the facility. In some cases, the purchase may be exempt if the hospital buys equipment for a specific patient's personal use under a licensed physician's direction.

You may also owe use tax if your health care organization buys nonmedical items such as computers and furniture tax-free that are used in administration.



Software and technology

Technology companies not only make software, but they also buy a lot of it. [Some states tax software](#). Others don't. Rules can vary depending on whether a business purchases prewritten (canned) software, customized software, software as a service (SaaS), or even infrastructure as a service (IaaS). This can make it difficult to keep up with when and where technology companies must pay sales tax or remit use tax on their purchases.

The situation can become more complex depending on how many software licenses your business is buying and where your employees are located. Many technology companies employ remote workers. Often, state rules require that you apportion use tax based on where products are used (multiple points of use, or MPU).

In some cases, your business may be required to pay use tax on software you manufactured with the intent to sell but used internally, even if it's used for research and development. Other states carve out specific sales and use tax exemptions for materials used in research and development, including software.

Wholesale distribution

Distributors primarily sell tax-exempt goods for resale but sometimes use inventory for promotions or as samples. This can create consumer use tax liabilities.

For example, suppose your business places a large order for snack products intending to resell them to customers. Since you plan to offer them wholesale, you don't pay sales tax. But if you then decide to use some of the potato chips as free samples, you may owe use tax on the cost of the snacks you gave away.

Compliance checkpoint

Know where software you buy is used and how it's used. Track employee locations, especially for remote teams, and document software usage to help ensure accurate tax assessment.



Compliance checkpoint

Create a clear distinction between inventory for resale and internal use, and implement a tracking system to monitor inventory that is pulled for purposes other than what you originally intended.



Compliance checkpoint

Implement purchase order controls to verify tax-exempt qualifications and help ensure your organization remits use tax when required.



Compliance checkpoint

Establish procurement policies to track tax-exempt and taxable purchases and maintain detailed records to help ensure accurate tax reporting.

Education and nonprofits

Nonprofit organizations and educational institutions often assume all purchases are tax-exempt. However, this generally only applies if the state provides this exemption, they are qualified as a sales tax-exempt organization, and purchased items are used for qualified exempt purposes.

For educational institutions, qualified exempt purposes typically include classroom instruction and student support services. For nonprofits, exempt purposes include charitable programs such as food distribution, free medical clinics, and disaster relief. Materials tied to fundraising or a commercial activity don't meet this definition. Not using goods for exempt purposes can trigger use tax obligations.

For example, consider a university that purchases audiovisual equipment tax-free for use in the classroom. The university later rents the equipment for a corporate event. The state may consider the event a taxable commercial use, and the university would need to remit use tax on the rental value of the equipment.

Hospitality and food service

Hotels need beds. Restaurants require kitchen appliances, tables, and plates. Because these items are used as part of the service being sold, hospitality businesses may trigger use tax obligations if sales tax wasn't paid at the time of purchase, or if you underpaid sales tax.

As an example, your hotel in New York furnishes rooms with linens bought from an out-of-state supplier that doesn't charge sales tax. You'll likely need to self-assess and remit use tax in New York. If you plan to sell a plush bathrobe to a guest that you bought wholesale, you may need to charge and remit sales tax.

Automotive and transportation

The automotive and transportation industry faces many use tax challenges. Fleet vehicles, maintenance tools, and diagnostics equipment often cross state lines. Using them in multiple jurisdictions complicates compliance.

For example, if your trucking company services its fleet in-house in Texas using parts you purchased tax-free from a supplier in Montana, you may need to pay Texas consumer use tax.

Professional services

Lawyers, accountants, insurance agents, and others who provide professional services are [typically exempt](#) from collecting and remitting sales tax. But they may still owe use tax when they buy software, computers, or office supplies if they weren't charged sales tax.

For example, if your accounting firm in Alabama buys computer software from an out-of-state vendor that doesn't collect your home state's sales tax or calculates the wrong amount of sales tax, you may still need to report and pay use tax to the state of Alabama.

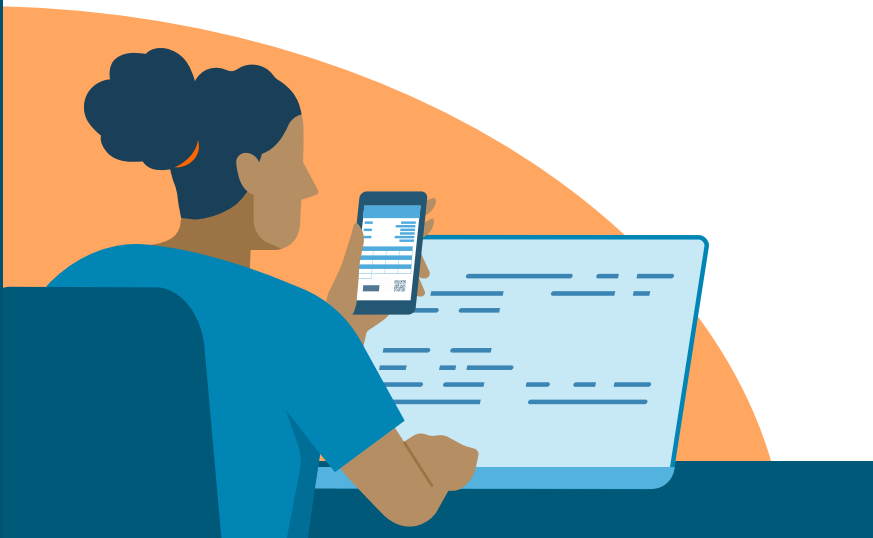
Compliance checkpoint

To help stay on top of your use tax obligations, review all maintenance expenses and consider implementing fleet tracking software if you haven't already.



Compliance checkpoint

Review vendor invoices to determine whether use tax should be paid, especially for major office purchases.



How to help avoid common use tax compliance mistakes

The Censuswide survey found 42% of respondents believe the cost of managing consumer use tax obligations is high for their business, with 23% indicating the average cost of managing consumer use tax is between \$10,000 and \$50,000 annually, and 20% saying it costs between \$50,001 and \$100,000.

Nearly a third of respondents to the Censuswide study indicated that audit risks are high with use tax. Among those who revealed that their business had been audited within the previous three years, 63% said consumer use tax was a substantial part of the audit process. Studies by Potentiate and Aberdeen Strategy & Research both identified consumer use tax liabilities as one of the [top five reasons businesses incur audit penalties](#).

Reporting and remitting the exact amount of use tax owed is necessary to reduce the likelihood of a negative audit.

To do this right, you need a reliable way to track your purchases and account for when your business used, stored, or consumed each item. Relying on spreadsheets is burdensome and comes with the risk of human error.

Calculating tax can also be difficult, especially when trying to track tax rates across multiple jurisdictions. Use tax rates mirror sales tax rates in most states, but not always. [Missouri](#), for example, applies lower use tax rates in some cities, counties, and special taxing districts. Plus, tax rates frequently change. In 2023, there were 11,192 sales and use tax rate updates in the United States.

You can avoid a headache by using software that tracks purchases and applies sales and use taxes automatically. Automating consumer use tax compliance isn't just easier; it improves accuracy and reduces risk.



Best practices for managing use tax

Improving consumer use tax compliance starts with putting these best practices into place:

1. Develop an internal use tax policy.

A documented internal use tax policy emphasizes the importance of compliance and provides guidelines for staff. A strong internal policy includes:

- Roles and responsibilities that show who is in charge of tracking and reporting purchases subject to use tax
- Processes for how use tax will be calculated, recorded, and reported
- Approval workflows, including periodic reviews of purchases to catch errors before tax filings
- Audit preparation procedures that state how and where detailed records of tax-exempt purchases, exemption certificates, and self-assessed use tax payments will be stored

2. Use technology to automatically track purchases and report consumer use tax.

An automated consumer use tax solution helps to simplify compliance. Choose a vendor that provides an end-to-end compliance platform that automatically verifies whether vendors or suppliers collected sales tax and charged the right rates. An automated solution can identify both overpayments and underpaid taxes on purchases, provide vendors with exemption certificates, and add use tax owed to your sales and use tax returns.

3. Train teams to identify and report taxable purchases.

Ensuring employees across procurement, finance, and accounts payable departments recognize when use tax applies is critical to your compliance. Implement a structured training program that helps teams differentiate between taxable and exempt purchases, identify when vendors didn't charge sales tax correctly, and flag transactions for use tax self-assessment.



Avalara AvaTax for Accounts Payable streamlines consumer use tax compliance

[Avalara AvaTax for Accounts Payable](#) helps solve one of the most overlooked tax challenges businesses face today: consumer use tax compliance. Manually validating purchases, determining the correct tax, and accruing use tax is not only time-consuming but also prone to costly errors. Underpaying risks audit penalties, while overpaying results in avoidable expenses. Avalara AvaTax for Accounts Payable addresses these problems with an automated, intelligent approach that brings more accuracy, control, and efficiency to your accounts payable and use tax processes.

Whether uploading transactions or integrating into your purchasing system for real-time determinations, our hybrid solution is scalable to your organization's tech stack and compliance maturity. The solution consolidates purchase data from most ERP, procurement, or AP platforms into a centralized system of record.

Define, configure, and maintain tax rules across vendor settings, general ledger accounts, item taxability profiles, cost centers, allocation methods, risk thresholds, and more – all without coding or IT involvement. The rule engine is built to support tax teams with control and configurability, no matter how complex or unique the business needs. It flags underpayments, captures overpayments, and supports automated accruals and filings, all within a unified compliance portal designed specifically for end-to-end tax compliance.

Find out how your business can get a handle on consumer use tax compliance with automation. Contact an Avalara consumer use tax compliance specialist today.

[Get in touch](#)





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Avalara makes tax compliance faster, easier, more accurate, and more reliable for 43,000+ business and government customers in over 75 countries. Tax compliance automation software solutions from Avalara leverage 1,400+ signed partner integrations across leading ecommerce, ERP, and other billing systems to power tax calculations, document management, tax return filing, and tax content access.

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