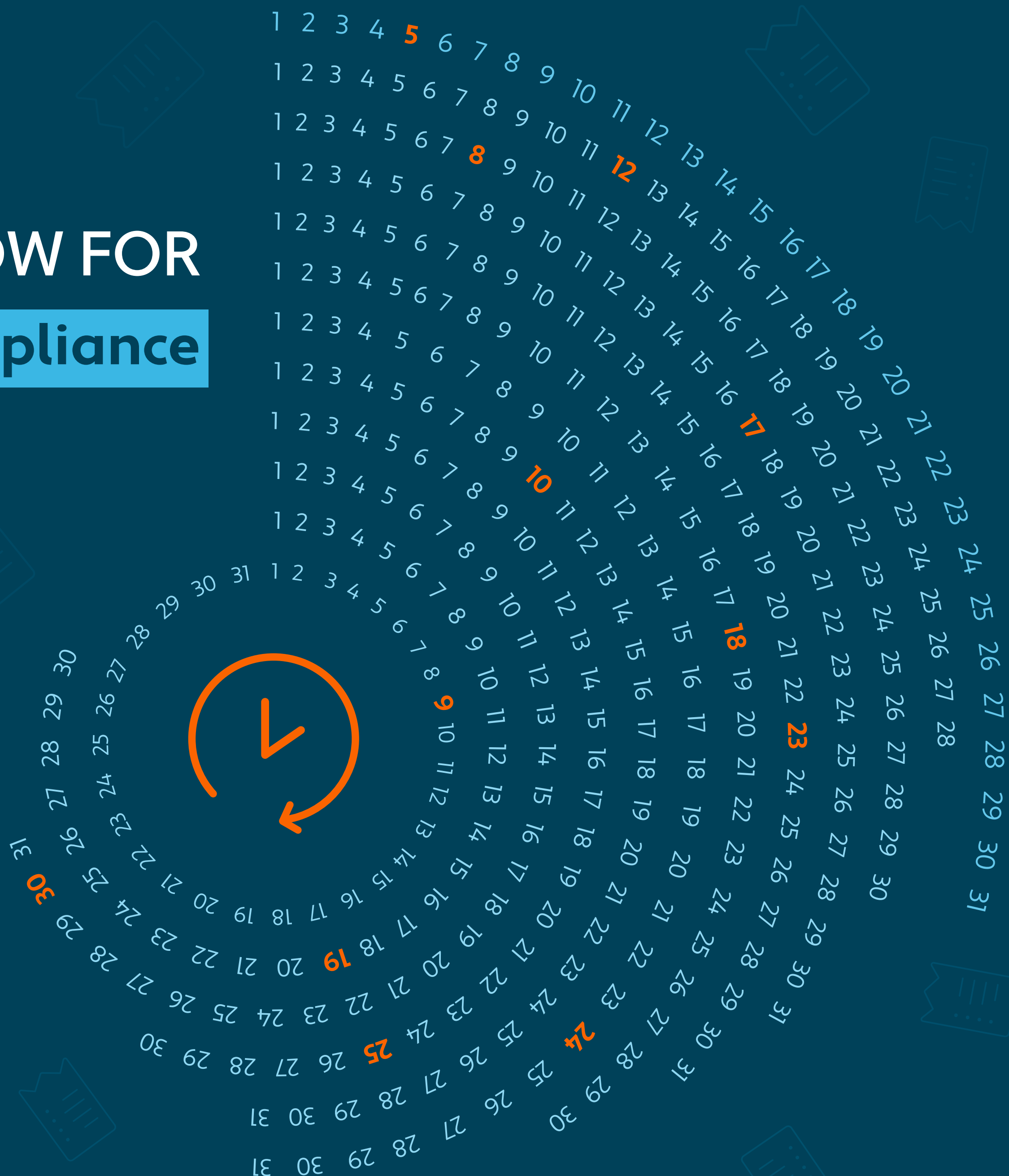
WHAT SUBSCRIPTION BUSINESSES SHOULD KNOW FOR sales tax compliance



GUIDE

Avalara
Tax compliance done right

Contents

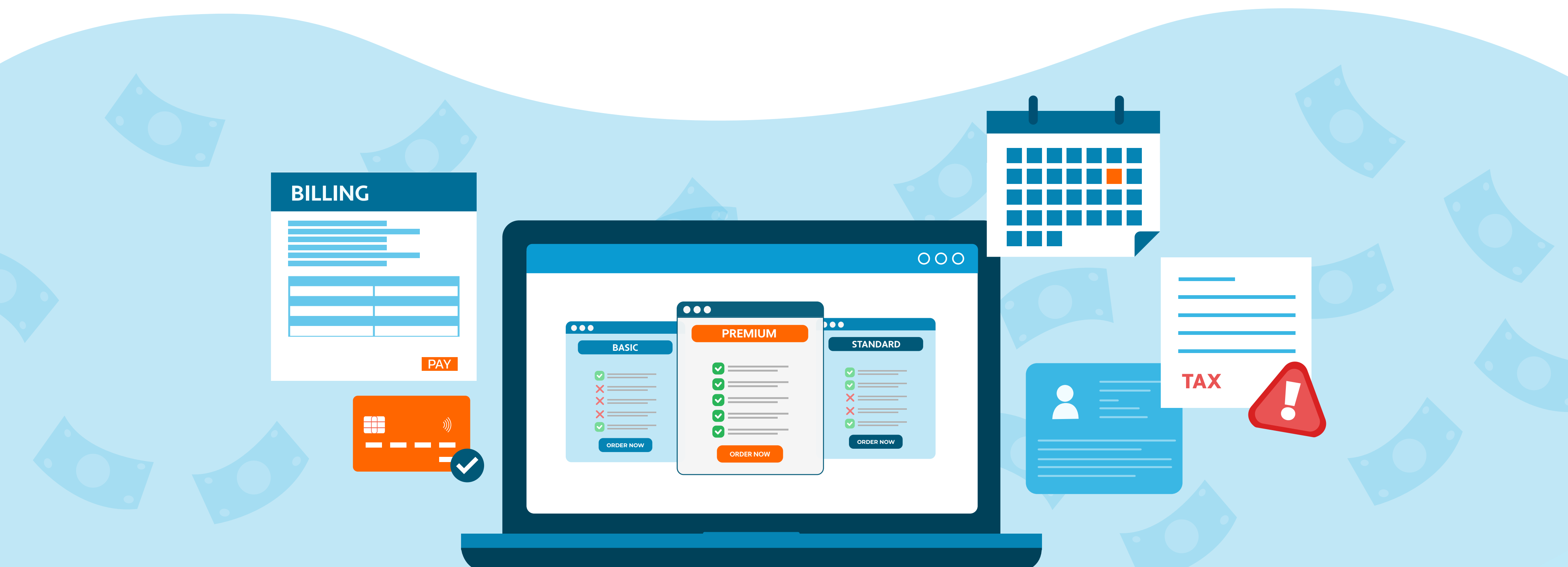
Introduction

Consumers have shown they're willing to be billed on a recurring basis for many services and products like streaming, software, fitness memberships, meal kits, and curated boxes of everything from cosmetics to pet treats.

Selling this way offers businesses numerous advantages, like predictable cash flow. Businesses can focus on keeping existing customers and aren't under the same pressures as a company that must always acquire new buyers through one-time sales. Tier-based subscriptions allow companies to upsell customers to more expensive plans. Similarly, payment plans based on usage help businesses scale as consumers purchase more; for example, a cloud storage provider that charges per gigabyte.

However, recurring billing often translates to recurring sales tax risk.

This guide helps you navigate sales tax compliance for your subscription or usage-based business and stay in good standing with tax authorities.



Are subscriptions taxable?

Like many aspects of sales tax compliance, there's no simple answer. Whether or not subscriptions are taxable depends on what you sell and where you sell. Multiple factors come into play, including product taxability laws and where your business has nexus.

Generally, the more locations where you have customers, the more likely your business will have to collect and remit sales tax. Understanding the taxability of products and services you sell through recurring payments is critical to staying compliant.

Why recurring billing complicates sales tax compliance

To stay compliant, businesses must accurately calculate and collect sales tax with each subscription renewal. They must determine the correct tax rate based on the customer's location and current rules in each jurisdiction. While that might seem straightforward, there's no one-size-fits-all approach to how states and local governments tax products and services.

Subscription billing and usage-based billing models typically generate hundreds or thousands of taxable transactions each billing cycle. This high volume means that any inaccuracies in calculating and collecting sales tax can be substantial. Businesses that fail to properly collect and remit sales tax can incur fines and audit penalties in addition to owing back taxes.

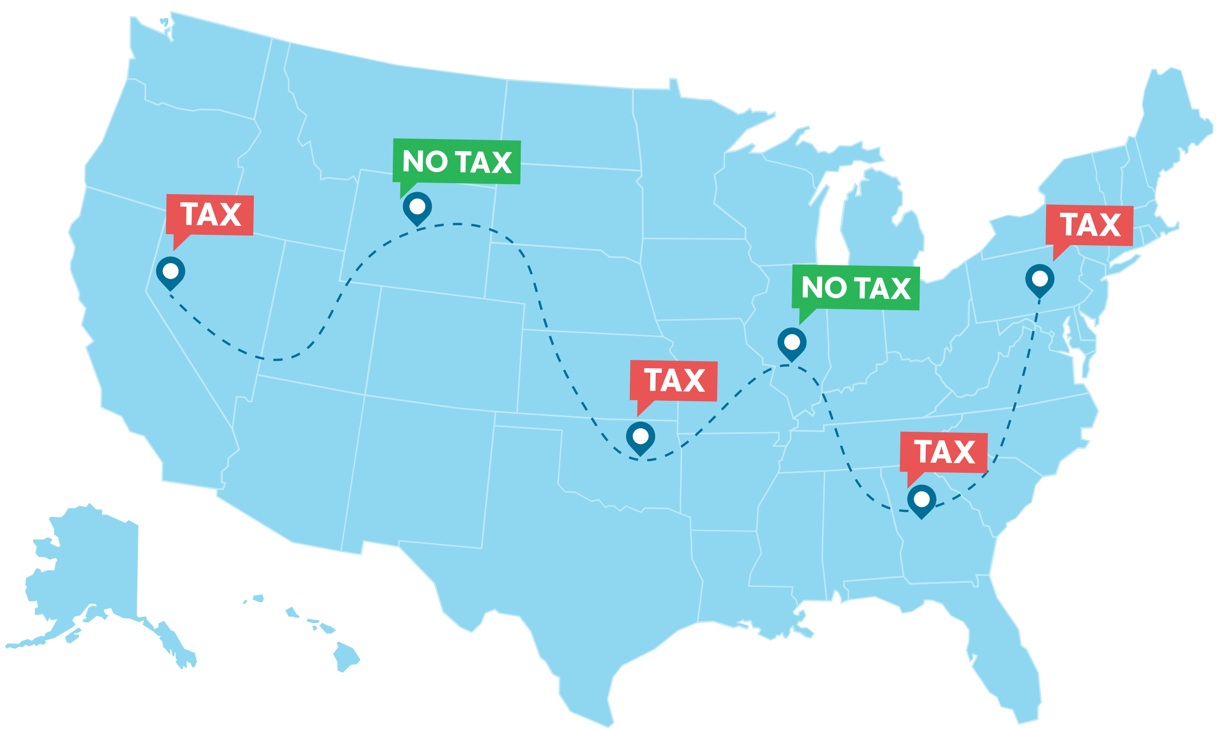
Tax compliance is even more complicated for businesses that sell certain products and services through recurring revenue models, like streaming platforms, cloud computing providers, and SaaS companies. These companies may be **on the hook for a multitude of communications taxes** in addition to sales tax.

Selling in multiple jurisdictions is more complex because of economic nexus

Tax compliance becomes more complex as your business gains customers in new places.

Economic nexus laws have been adopted by every state with a sales tax, Washington, D.C., and some jurisdictions in Alaska. Economic nexus establishes a tax collection obligation on economic activity alone. Nexus thresholds vary by state and are based on taxable sales revenue, the number of separate sales transactions, or both.

Because of economic nexus laws, it's important for your business to proactively monitor sales volumes in states where you're not registered to remit sales tax. Subscription selling models are usually associated with a distributed customer base and a large quantity of transactions, especially if you sell online or through a marketplace. That makes it easy to unknowingly bump up against or exceed a threshold and establish nexus in one or more states.



How to calculate sales tax rates for subscription customers

Keeping track of where your company has nexus is just the first hurdle. You also must know the exact location in which a transaction is taxable. There are more than 12,000 U.S. sales and use tax jurisdictions.

You're likely to run into problems **if you're using ZIP codes** to determine sales tax rates. ZIP codes don't neatly align with sales tax jurisdictions. It's even possible for two customers who live a block away from each other to reside in different taxing jurisdictions with different sales tax rates. Geolocation technology is the fix. It assigns rates and rules with rooftop-level precision.

Businesses also need to understand **sales tax sourcing**. Most states use destination sourcing, which means you need to collect tax based on the rate at either the buyer's billing address or the location where they first used the product.

However, some states use origin sourcing in which the sale is sourced to the seller's location based on where the order was taken or fulfilled.

Several states apply destination sourcing to some transactions and origin sourcing to others. States can also have different rules for in-state businesses and out-of-state businesses. And, some states like **Illinois** have complex rules based on where marketplace sales are fulfilled.

Sales tax sourcing isn't always clear with digital products. A customer who lives in Texas can easily sign up for an audiobook subscription service while vacationing in Hawaii.

Even if you know which tax rates apply today, that doesn't mean they'll be the same tomorrow. Tax rates and rules change frequently, making it difficult to stay on top of the latest regulations everywhere you sell. In 2023, there were 11,192 sales and use tax rate updates in the U.S.

CUSTOMER SUCCESS STORY

EASE OF INTEGRATION MAKES SALES TAX SIMPLER AT WONDERSIGN

Wondersign, based in Tampa, Florida, is a cloud-based syndication platform that automates product catalogs and pricing across channels, from website to the showroom. The company's flagship product, Catalog Kiosk, is used mainly by furniture retailers to create an "endless aisle" shopping experience by syncing live data feeds from more than 40 manufacturers.

As Wondersign grows, Avalara scales with the business to handle complex sales and use tax calculations and returns filing.

Wondersign uses Chargebee, a subscription management and recurring billing product, for invoicing. An invoice from Wondersign may include a subscription fee for their SaaS offering as well as kiosk purchases and installation services – all of which are taxed differently or may be tax exempt.

"The API connection to Avalara makes sure we apply the right tax to each line item based on rates for the applicable jurisdictions," says Hector Camacho, the company's controller.

"Doing this work internally would be costly and inefficient and would require staffing up the internal accounting team," says Camacho. "There are certain things that make sense to outsource. This is the perfect example. There is no need for us to become experts on sales tax and try to keep up with rate changes in different jurisdictions."

[Read the full story]

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HECTOR CAMACHO

CONTROLLER, WONDERSIGN

Subscription taxability: How product and service types affect sales tax

Where you sell is just part of the equation. What you sell also impacts which tax rates and rules apply to your sales, or whether your products and services are taxed at all in some cases. Like sales tax rates, **product taxability** rules vary across jurisdictions and are subject to change.

Tangible personal property, or physical goods, is typically subject to sales and use tax unless specifically exempt by law. But there are many exceptions.

Take food, for instance. Unprepared grocery items included in meal kits and packaged coffee beans are exempt in some states and taxed at a reduced rate in others. Tax compliance is even trickier if your subscription service includes candy. **Many states tax candy differently from other foods**. The 24 states that are members of the **Streamlined Sales and Use Tax Agreement** (SSUTA) don't consider products to be candy if they contain flour or require refrigeration. Like candy, many other product definitions can be very specific.

Clothing subscription services and personalized styling fees may be taxed or not, depending on the state. Clothing and footwear priced less than $110 is generally exempt from **New York** state sales tax, while clothing and footwear at a higher price is taxable. Most local governments in New York still charge local sales tax on clothing and footwear purchases that cost less than $110. Even states that exempt apparel may still tax certain products like accessories or formal wear.

Taxability is particularly complicated for businesses that sell **digital goods** like streaming services, music, podcasts, and electronically distributed software. Most sales tax laws were written before these products existed. Some states have tried to apply old laws to these newer products. Others have added definitions.

The 24 Streamlined Sales Tax (SST) states adhere to a standardized definition for certain products including digital books, digital audio works, and digital audiovisual works. But SST members, like other states, can still tax or exempt digital products as they wish.

SALES TAX HOLIDAYS: WHEN TAXABLE GOODS AREN'T TAXED

Sales tax holidays are specific days when sales tax isn't charged on certain products and services. During these temporary reprieves, some states exempt goods like clothing, food, and computer software.

Massachusetts exempts all tangible personal property bought for personal use during its annual sales tax holiday. **Ohio** will offer a tax-free period on most tangible personal property priced less than $500 if the state has a budget surplus of a certain amount.

Participation in sales tax holidays is typically mandatory for sellers, including those located out of state.

WHEN DOES SALES TAX APPLY TO SERVICES?

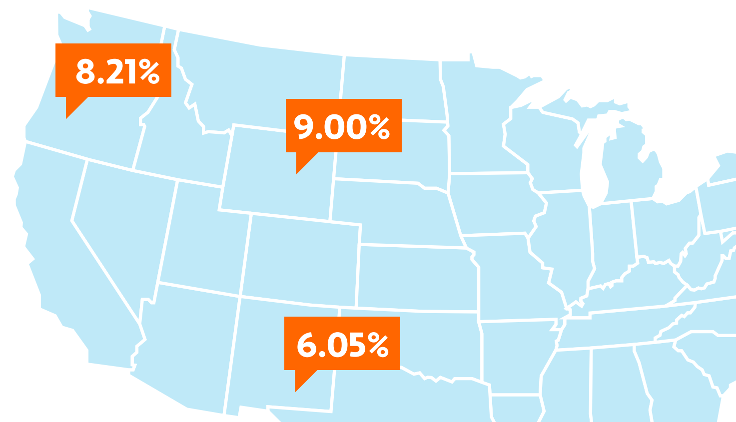
States also take different approaches to **taxing services**. These can include services that involve recurring payments, such as health clubs, sports facilities, and weight loss centers; social club and country club dues; and memberships for personal care services, such as tanning or massage.

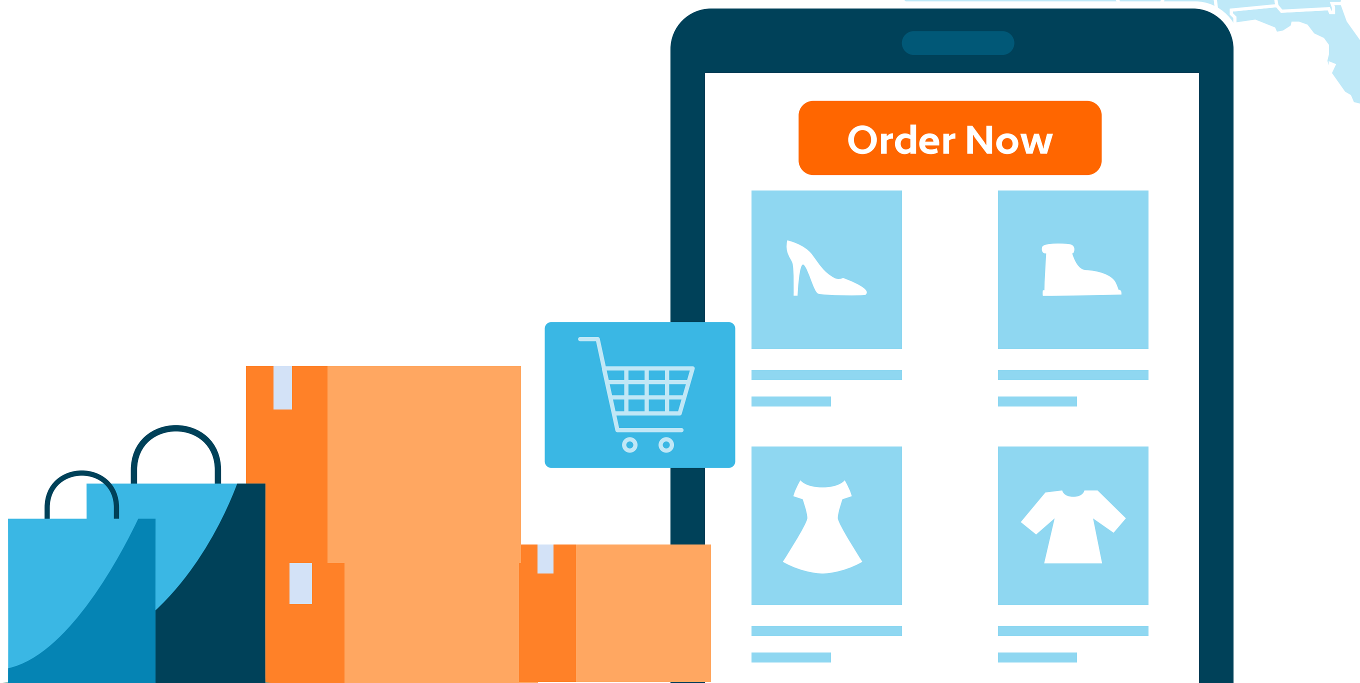
Four states (Hawaii, New Mexico, South Dakota, and West Virginia) tax services by default, with exceptions for services specifically exempted by law. Five states (Alaska, Delaware, Montana, New Hampshire, and Oregon) don't impose a statewide sales tax on goods or services. That leaves 41 states and the District of Columbia that each tax a different variety of services.

PRODUCT AND SERVICE BUNDLING: WHEN EXEMPT PURCHASES BECOME TAXABLE

If your business bundles both taxable and nontaxable products or services together, you may be required to apply sales tax to the entire purchase. In some cases, states allow businesses to collect and remit sales tax only for the taxable portion of the bundle.

If you sell a mobile phone along with a service plan in **California**, you're required to charge tax on the unbundled cost. You must account for the full price you'd charge for the phone without a service contract even if you sell the phone at a discount.





CUSTOMER SUCCESS STORY

FUBOTV SCORES BY LEAVING MULTI-TAX COMPLIANCE TO AVALARA

Streaming company fuboTV Inc. aims to turn passive viewers into active participants and define a new category of interactive sports and entertainment television. Based in New York, the company has customers in all 50 states and is growing its international footprint through acquisitions.

Senior Vice President and Controller Larry Wills joined fuboTV in 2018. He came on shortly after the U.S. Supreme Court's landmark decision in South Dakota v. Wayfair, Inc. that led to state economic nexus laws. Since then, Wills has watched a growing number of states tax streaming services.

Wills wanted an automated tax compliance solution that would integrate well with Recurly, the system fuboTV uses to sign up and bill subscribers. Avalara has a prebuilt connector to Recurly.

Avalara AvaTax for Communications enables fuboTV to more accurately calculate taxes, fees, and surcharges on its subscriptions while **Avalara Returns for Communications** helps the company file 1,000 tax returns per year on time.

"Avalara does all the heavy lifting for us," Wills says. "We would have had to staff up pretty significantly and look for people with that specific expertise. Secondly, we would have needed to have some access to a database telling us the rates and filing frequencies. I couldn't even begin to tell you how much that would have cost, nor would I be able to tell you how long it would have taken to build that out from scratch. It would have been a massive undertaking."

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LARRY WILLS

SENIOR VICE PRESIDENT AND CONTROLLER, FUBOTV

Managing tax exemptions for subscription-based customers

Government agencies and nonprofit organizations are frequent buyers of SaaS, cloud platforms, and digital content like electronic databases for research or fundraising. They may also purchase other products such as printer ink or janitorial supplies through subscriptions. Most of the time, these organizations are exempt from paying sales tax.

If your business makes tax-exempt sales to government agencies or nonprofit organizations, you'll need a reliable method to track, collect, verify, and store exemption certificates.

While many ERP systems allow you to flag customers as tax exempt, they typically don't make the grade for exemption certificate management.

Trying to manage large volumes of tax-exempt sales transactions manually is cumbersome and prone to inaccuracies. Studies by Potentiate and Aberdeen Strategy & Research both found that missing exemption certificates are among the top five reasons businesses incur audit penalties.

Selling subscription services internationally

So far, we've focused on sales tax. If your subscription business sells internationally, you'll also have to comply with complex regulations for global trade compliance.

Calculating and collecting VAT, GST, and customs duties and import taxes becomes more challenging as you expand into new markets. Your business will also need to accurately assign Harmonized System (HS) codes to each product you ship to avoid added costs or delays at the border.

Your company must also be ready to comply with the rise in e-invoicing and live reporting mandates. Over 80 countries worldwide have announced – or already require – e-invoicing.

Avalara helps subscription businesses stay compliant

Sales tax compliance for subscription businesses may be tricky, but automation can make it easier. Avalara streamlines tax compliance to support subscription and usage-based sales models.

Avalara integrates with leading billing platforms your business already uses. Our end-to-end, cloud-based tax compliance solutions help you stay on top of changing regulations and meet your obligations across the United States and countries where you sell.

Avalara AvaTax calculates sales and use tax, VAT, GST, and industry-specific tax types on every recurring invoice or usage-based charge. It applies regularly updated rates and tax rules based on customer location, product type, and transaction details, helping subscription businesses stay compliant even as rules change.

Avalara Exemption Certificate Management streamlines exemption certificate collection and validation at scale. It helps businesses that regularly sell to exempt customers, such as nonprofits or governments, automate exemption handling across all recurring transactions, reducing audit risks.

Avalara Returns automates the process of preparing and filing sales tax returns across jurisdictions. For businesses with recurring revenue, this reduces the burden of tracking filing calendars in multiple states and ensures taxes are remitted on time, every time.

Avalara Cross-Border simplifies compliance for subscription businesses that sell internationally. Our solutions calculate duties and taxes upfront and classify products accurately, helping prevent delays at borders and ensure customers aren't hit with surprise fees.

Avalara E-Invoicing and Live Reporting helps subscription-based businesses future-proof themselves in the face of increasing global mandates. The solution helps ensure each invoice includes accurate tax data and complies with country-specific reporting formats.

Find out how automating tax compliance with Avalara can give you more time to focus on your key priority – selling.

Contact one of our sales tax compliance specialists to discuss the best solutions for your business.

ABOUT AVALARA

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. Visit **avalara.com** to improve your compliance journey.