Avalara

The software & AI compliance gap

Navigating tax complexity as you scale

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The software & AI compliance gap



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Agenda

1. Why software growth creates hidden tax risk
2. Why software and AI taxability is so hard to pin down
3. When growth creates new tax obligations
4. The operational risks that slow growth
5. Building tax infrastructure for the next stage of growth

Why software creates hidden tax risk

Why software growth creates hidden tax risk

How SaaS, AI-powered products, subscriptions, usage-based pricing, and global expansion accelerate tax complexity



SaaS & subscriptions

Recurring billing creates recurring tax risk. With many states setting economic nexus at 200 transactions per year, as few as 17 monthly subscribers in a single state can trigger a new tax obligation.



Usage-based pricing & hybrid models

Bundling software with taxable services — or combining hardware with licenses — creates a mixed taxability problem. What's taxable within that recurring or usage-based revenue varies wildly state by state.



AI & new digital products

Tax laws are slow to catch up with new technology. The same AI tool or digital product can be fully taxable in one state, completely exempt in another, or land in a "sometimes taxable" gray area — with no settled national answer.



Global expansion

Expanding across regions multiplies compliance obligations. Software companies must navigate international tax, data privacy, data sovereignty, and e-invoicing mandates across more than 50 countries.

The business impact of getting it wrong

Audits — more frequent, more expensive

- States are actively deploying technology to identify noncompliant companies — audit volume is rising
- Penalty fees range from $10,000 to more than $1 million depending on their severity

Penalties and interest — they stack

- Businesses that fail to meet tax obligations owe back taxes, penalties, and interest
- One missed accrual threshold can generate thousands of $'s in avoidable penalties

Operational burden — Finance, IT, and Product teams pay the price

- Manual tax management consumes up to 510 hours per year just on returns and filing from determining obligations through remitting taxes, businesses spent an average of 147 hours and more than $14,000 per month on tax compliance

Delayed expansion — unresolved liability freezes growth

- Unresolved tax exposure can make a company "all but toxic" when it comes time to raise capital, attract investors, or pursue M&A
- If you entered three new markets next quarter, would your compliance scale automatically or become the bottleneck that slows growth?

CPE POLL QUESTION

What is your biggest indirect tax challenge as a software company?

A	Taxability of SaaS, AI, or digital products
B	Tracking economic nexus thresholds
C	Managing exemption certificates
D	Filing and remittance across multiple jurisdictions
E	Others

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Why software and AI taxability is so hard to pin down

Three variables determine software taxability

The first taxability decision depends on **what is sold**, **how it is delivered**, and **what rights the customer receives**



Software classification

Canned, custom, SaaS, AI, digital service



Delivery method

Tangible, downloaded, hosted, API-based



Access rights

Permanent, temporary, subscription, usage-based



Classify first. Then determine treatment.

Clear inputs support consistent treatment

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Transaction context changes the outcome

After classification, delivery, and access rights, the **final treatment depends on where, who, and how the software is sold**



Customer location

State, country, jurisdiction



Customer type

B2B, reseller, exempt



Sales channel

Direct, partner, marketplace



Context decides the outcome

Treatment depends on the full transaction context

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Product by product

How each category faces its own taxability logic



SaaS

SaaS delivery creates a taxability tangle subject to sourcing rules in both the vendor's and customer's jurisdiction — triggering potential obligations in every state or country where customers buy.



AI-Powered products

Indiana was the first state to rule on AI chatbot taxability — finding subscription-based AI chat exempt because no software code is delivered. But Indiana acknowledged other states could reach the opposite conclusion.



APIs and data processing

Texas expanded its data processing definition in 2025 to include computerized entry, retrieval, search, and storage of data — effectively reaching many API-based services.



Electronically Delivered / Downloadable Software

Delivery method is one of the most consequential taxability variables. Colorado (until 1/1/2027), for example, taxes computer software in some cases — but not when delivered electronically or transferred by load and leave.



Digital Products

Some jurisdictions apply amusement tax to streaming and digital content. Chicago is the primary example — imposing both an amusement tax and a social media amusement tax on electronically delivered content.

How taxability can depend on delivery method, customer type, location of use, and jurisdiction-specific rules



Delivery method

- A single product sold as both a physical disc and digital download — with support, installation, and a license included — can be taxed at different rates depending on where it was purchased, who bought it, and how it's distributed.
- In certain states, SaaS is not taxable — either because the state doesn't tax electronically delivered software, or because there's no transfer of tangible personal property, ownership, or license to the customer.

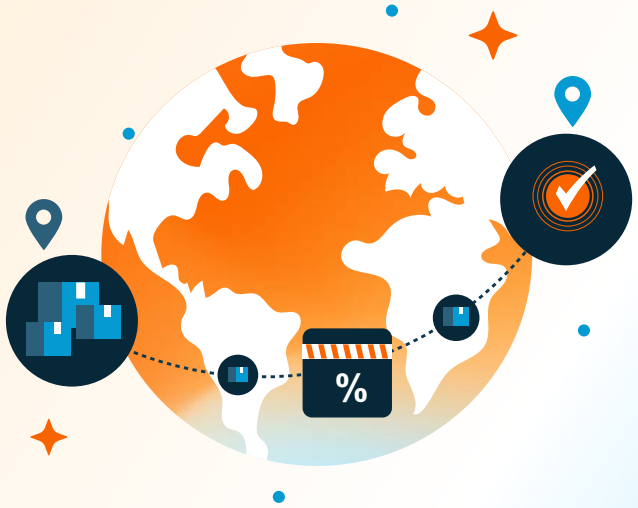
How taxability can depend on delivery method, customer type, location of use, and jurisdiction-specific rules



Customer type

- Who the customer is directly affects taxability. In Maryland, SaaS purchased for enterprise use is treated differently from an individual purchase — which is subject to the full 6% state sales and use tax rate.
- Internationally, whether a transaction is B2B or B2C determines whether a reverse charge mechanism applies — exempting the seller from local registration entirely, or triggering full registration requirements.

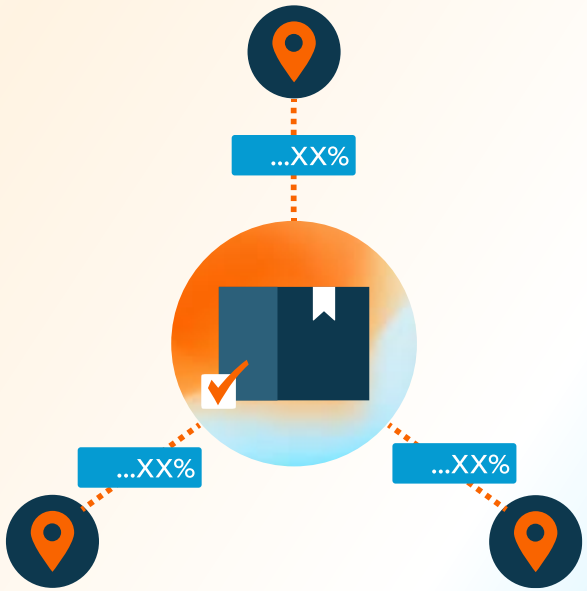
How taxability can depend on delivery method, customer type, location of use, and jurisdiction-specific rules



Location of use

- Pinpointing the location of digital transactions is critical — and notoriously difficult. If you only have a billing address or ZIP code, that may not reflect where the product is first used or where possession transfers, making accurate sourcing a persistent challenge for both businesses and tax authorities.
- Ambiguous sourcing rules create a compounding risk: because sellers don't need to obtain a full address for digital transactions, the same transaction could end up taxed by multiple jurisdictions — or by none at all.

How taxability can depend on delivery method, customer type, location of use, and jurisdiction-specific rules



Jurisdiction-specific rules

- Every U.S. state sets its own software tax rules — and in states with multiple tax jurisdictions, each one may apply different taxability rules to the same product or service, making accurate calculation especially complex.
- States have taken varying and inconsistent positions on software taxability. In some states, SaaS is not taxable at all — and even the average sales price used to determine taxability can shift depending on how a product is sold.

What about AI?

AI extends the software taxability question



Delivery model

SaaS, API, embedded workflow



Use rights

Access, inputs, outputs



User output

Prompts, generated results



Policy movement

Guidance, legislation, digital services



Revenue model

Subscription, usage, service fees

AI taxability depends on access, output, and revenue structure

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CPE POLL QUESTION

Have you integrated AI or automation into your tax compliance workflow?

A	Yes, fully automated
B	Partially — some automation, still manual in parts
C	No, still mostly manual
D	Thinking about it

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When growth creates new tax obligations

Growth creates nexus risk before registration



5 Ways U.S. Nexus Can Be Created

Economic Nexus

Sales or transaction thresholds

Physical Nexus

Employees, contractors, visits

Marketplace Nexus

Platform collection rules

Affiliate Nexus

Common ownership

Click-through Nexus

Sales generated through in-state referral links or partners

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Growth events that most commonly create hidden tax exposure



- Crossing economic Nexus thresholds
- Hiring remote employees or opening new offices
- Launching new products or shifting pricing models
- Expanding into new sales channels
- Acquisitions and M&A activity
- International expansion



Economic business expansion creates new tax obligations

Sales volume

- Crossing state-specific economic nexus thresholds (most commonly $100,000 in gross or taxable sales) automatically mandates sales tax registration, collection, and remittance—even without an in-state office or workforce. For software companies, many jurisdictions evaluate thresholds using gross revenue, meaning exempt sales or non-taxable software services can still trigger mandatory tax registration and filing obligations.

Transaction volume

- SaaS billing and monthly self-serve subscriptions can breach individual transaction count thresholds long before hitting dollar revenue limits. Because recurring transactions accumulate rapidly, subscription models frequently trigger unexpected multi-state compliance obligations.

Physical business expansion also create new tax obligations

Remote employees

- SaaS subscriptions are typically purchased and invoiced at corporate HQ, but taxability depends on where software is actually consumed. Distributing licenses to remote employees across multiple states creates complex Multiple Points of Use (MPU) allocation obligations—leading to frequent sales tax overpayments in non-taxing states and hidden consumer use tax under-accruals and audit exposure where software is taxed.

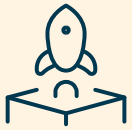
Physical office

- Opening a new sales office to accelerate regional growth simultaneously triggers physical nexus and potentially expands the taxable footprint of all digital products sold from or associated with that location.

Acquisition

- If the selling company has nexus in a state where the acquiring company does not (or vice versa), a business sale will likely establish nexus

New products, pricing models, and acquisitions (M&A due diligence) can create unexpected tax obligations



New products

If your business is evolving — launching or migrating new products or services to the cloud like payments and subscription models — your tax liability is likely changing too.



Pricing models

When software companies move to bundles — combining hardware, SaaS, and services — they face an allocation problem that every jurisdiction resolves differently. Mixed offerings require rule-based allocation across jurisdictions.



M&A

M&A activity is where undiscovered tax risk tends to surface at exactly the wrong moment — during due diligence, when the stakes are highest . Acquisitions create inconsistent tax treatment across entities and regions



Why multiple points of use makes software uniquely challenging

When companies sell or purchase software to be concurrently used in multiple tax jurisdictions

Burden shift	An MPU exemption shifts the compliance burden from the seller to a buyer who uses software or a related service concurrently in multiple states.
Certificate requirement	Where an MPU exemption is allowed, the buyer must provide the seller with an exemption certificate claiming multiple points of use. This affirms the buyer will use the software or service concurrently in multiple states.
Vendor relief	An MPU exemption certificate also relieves the vendor of the obligation to collect and remit sales tax.
Buyer Responsibility	It makes the buyer responsible for remitting use tax on the service based on a reasonable, consistent, and uniform method of apportionment that's supported by business records.
Limited eligibility	Only certain transactions are eligible for an MPU exemption, and only in certain states. States that provide an MPU exemption include Maryland, Massachusetts, Minnesota, Ohio, Texas, and Washington.

CPE POLL QUESTION

As a software company, what is your biggest area of concern when it comes to sales and use tax?

A	Keeping up with how states are taxing new products (AI, APIs, bundles)
B	Managing tax obligations triggered by growth events (new hires, M&A, new markets)
C	Manual processes and spreadsheets that don't scale with our revenue
D	Integrating tax compliance across our billing system and ERP
E	Allocating use tax amongst multiple points of use across company/employee locations

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The operational risks that slow growth

Common mistakes software companies make when managing multi-state compliance



Missing Filing Deadlines

Sales tax filing deadlines are hard to manage — regulatory changes are frequent, schedules vary by state and jurisdiction, and high transaction volumes across B2B and B2C channels require finance teams to accurately compile data across multiple systems simultaneously.



Misclassifying Taxable Goods and Exempt Transactions

Improperly classifying taxable goods as exempt, or vice versa, can have serious consequences. States frequently scrutinize high-value and high-volume transactions, making exemption classification errors especially costly in B2B sales channels.



Failure to Validate or Collect Exemption Certificates

Invalid or missing exemption certificates lead to costly mistakes — like charging tax on exempt transactions. This complicates reconciliation and often entitles customers to refunds or credits for erroneous charges.



Neglecting Use Tax Obligations

Multistate businesses are especially vulnerable to use tax noncompliance — obligations vary by jurisdiction, and failing to account for them exposes the business to direct financial liabilities and increases audit likelihood.



Inconsistent Tax Treatment Across Sales Channels

SaaS companies are significant users of online marketplaces, digital advertising, and referral programs — making inconsistent tax rules across sales platforms one of the highest-probability compliance risks in the industry.

Building tax infrastructure for the next stage of growth

Avalara

Avalara Agentic Tax & Compliance



Connected data creates operating control



From fragmented workflows to system-led control

Connected tax, invoice, ERP, and evidence data turns complexity into control

Tax logic

Sales tax, VAT, GST, nexus, taxability

Reporting

E-invoicing, ViDA, 1099

Evidence

Certificates, invoices, audit support

AI signals

Rule changes, data gaps, exceptions

Control that keeps up with global scale

- Detect rule changes faster
- Apply tax logic consistently
- Validate invoices before failure
- Flag evidence gaps early
- Push actions into workflows

Fewer gaps. Faster decisions.

The winning playbook for operating confidence

How global software businesses reduce tax complexity as they scale

Identify → Classify → Evidence → Automate

Where exposure is emerging: Nexus, thresholds, market entry

What is being sold Software, SaaS, service, bundle

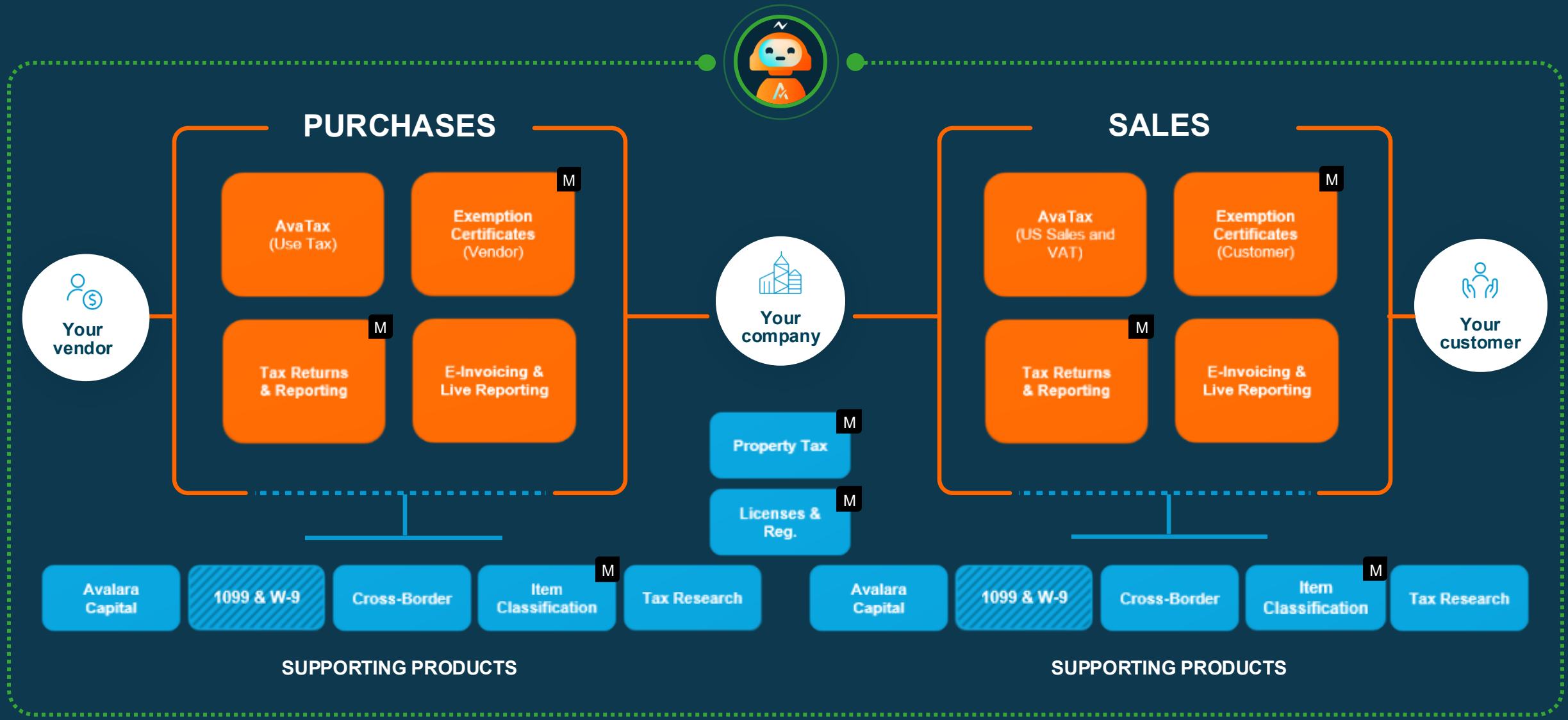
Why treatment is defensible: Invoice, certificate, contract

What is repeatable: Tax logic, ERP, billing workflows

Systems must absorb scale

Avalara products and services ›

AI-powered order-to-cash (sales) and procure-to-pay (purchases) compliance workflows



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CPE POLL QUESTION

Would you like to speak with an Avalara representative about these products?

A	AvaTax for Software
B	Exemption Certificate Management
C	Managed Returns
D	Cross-Border / VAT / E-Invoicing
E	Other

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Q&A


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Tax compliance done right