



What Companies Know About Sales Tax Compliance

Wakefield Research uncovers the highs
and lows from the tax pros

One would think that managing sales and use tax would be old hat by now

because companies have been managing it since the beginning of taxes, but more and more organizations are facing greater challenges when it comes to compliance – and for good reason. Online sales are skyrocketing while state revenues are in decline across the U.S. As lawmakers evolve their state’s tax rules to shore up deficits, the tax landscape is in constant flux, leaving many accounting and finance pros in the dark.

Leading research firm Wakefield Research set out to investigate why sales and use tax compliance is quickly becoming one of the more complicated parts of doing business. This report draws upon a 2017 survey, which investigated what leading and emerging companies in the U.S. know (and don’t know) about sales tax compliance – and, more importantly – what the accounting and finance professionals in the trenches are doing to keep up with the ever-changing tax rules as they maintain accurate accounting processes to safeguard their business from potential audits.

About the survey

The survey, conducted in May 2017, contains online responses from over 400 U.S. finance and accounting professionals across several industries, ranging from ecommerce and retail, software and technology, manufacturing and distribution, among others. The survey covered a wide range of topics from proposed federal legislation to nexus, sales and use tax audits to the cost of compliance, and more. Companies surveyed have annual revenues of \$10 million or more.

Compliance Risk on the Rise: Ecommerce Boom Fuels More Regulatory Requirements



Online = everywhere

91% of survey respondents sell online, but 39% are still only registered in only one state.

One in three respondents can't confirm whether it has a routine process for assessing its tax obligations for out-of-state activities and transactions.

According to Forrester Research, ecommerce sales will reach approximately \$500 billion by 2018, a 40% increase from 2014. Among the companies Wakefield surveyed, 97% sell online and most have significantly increased their online transactions in the past five years. The dramatic rise of online sales has not gone unnoticed by state and federal lawmakers. The U.S. Census Bureau indicates that sales and transactional taxes account for 47% of state revenue. Either through creative legislation (like broadening the definition of taxable services or mandating use tax reporting on all out-of-state transactions) or by asserting that tax is owed through audits, the states are intent to recover lost revenue. This creates more tax risk for companies of all sizes across all industries.

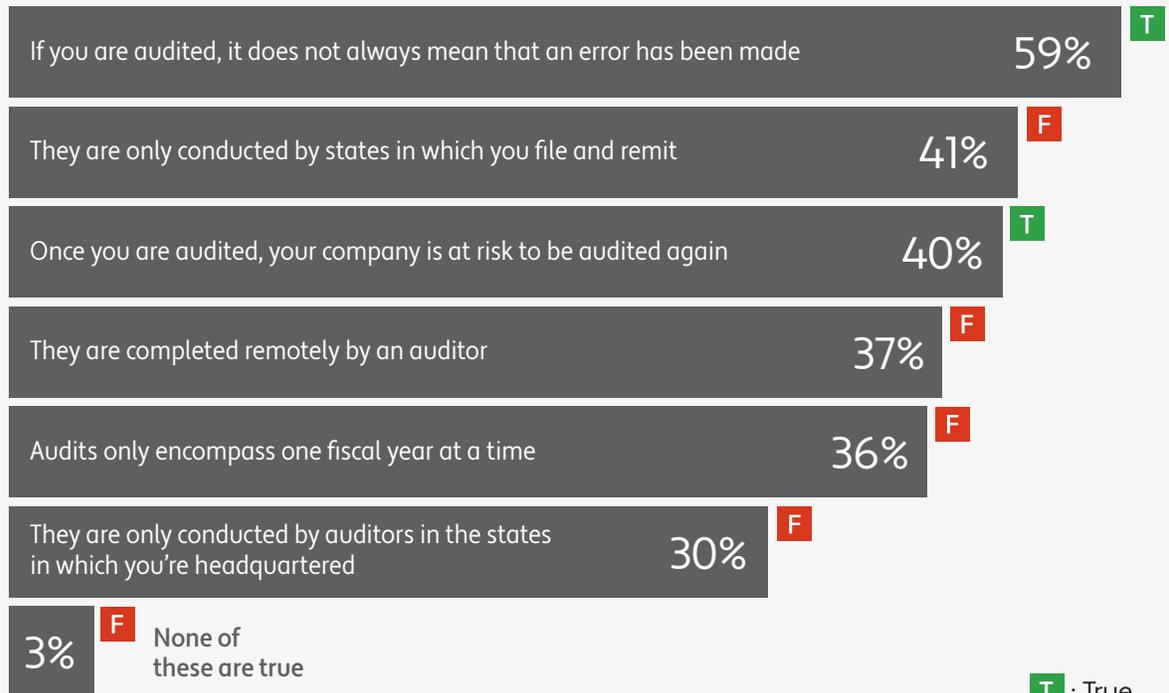
The survey found that there are many misconceptions around sales tax audits. One of the most striking is the belief among tax pros that a company is only at risk of being audited by states in which it files and remits. The truth is, states now routinely conduct audits on companies regardless of where it's headquartered or whether it has declared nexus. That makes audits a high risk area for any business. According to the survey, the average audit costs a company more than \$300,000 (up 163% from 2014).

Major audit mistakes found in the trenches:

- Missing documents, such as exemption certificates
- Applying the wrong sales tax rates or exempting tax on taxable transactions
- Producing the wrong documents requested by an auditor

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Which of the following, if any, are true about audits?

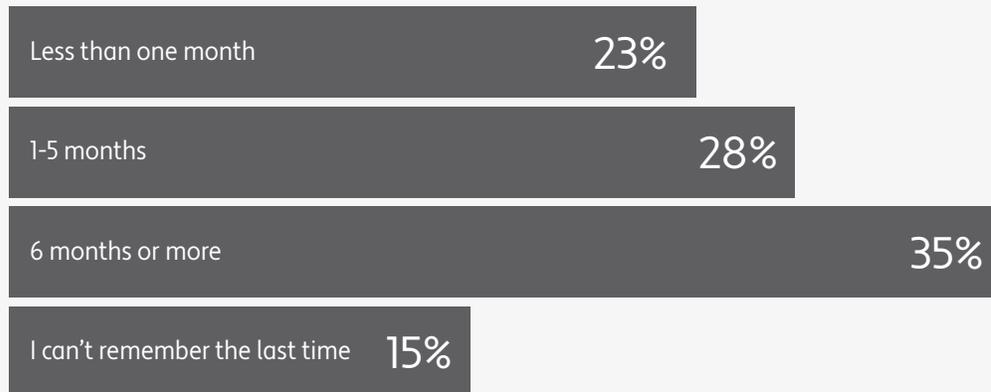


T : True
F : False

 **KEY TAKEAWAY:** 97% have one or more misconceptions about audit risk.

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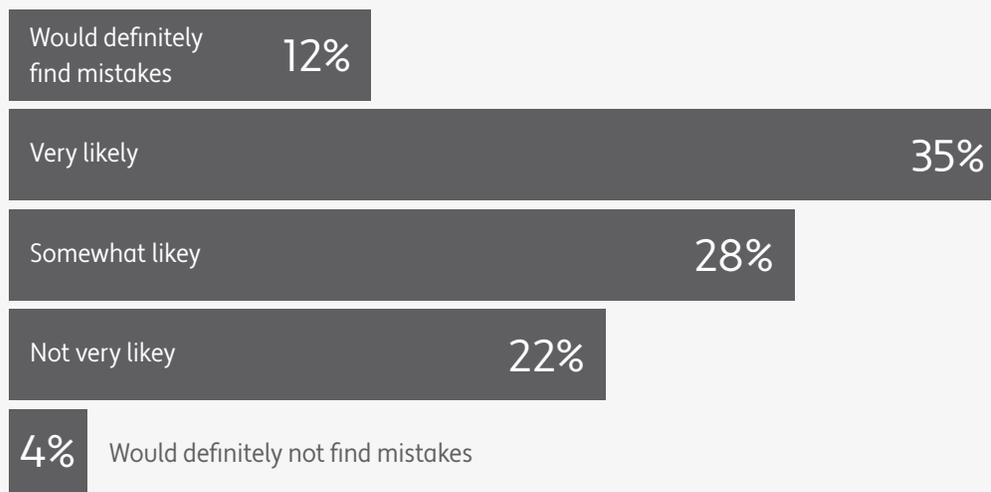
Approximately how long has it been since your company updated its sales tax compliance processes? Examples include updating exemption certificates and/or following new sales and use tax laws in applicable states.



KEY TAKEAWAY: The average time tax professionals update their sales tax compliance processes is six months.

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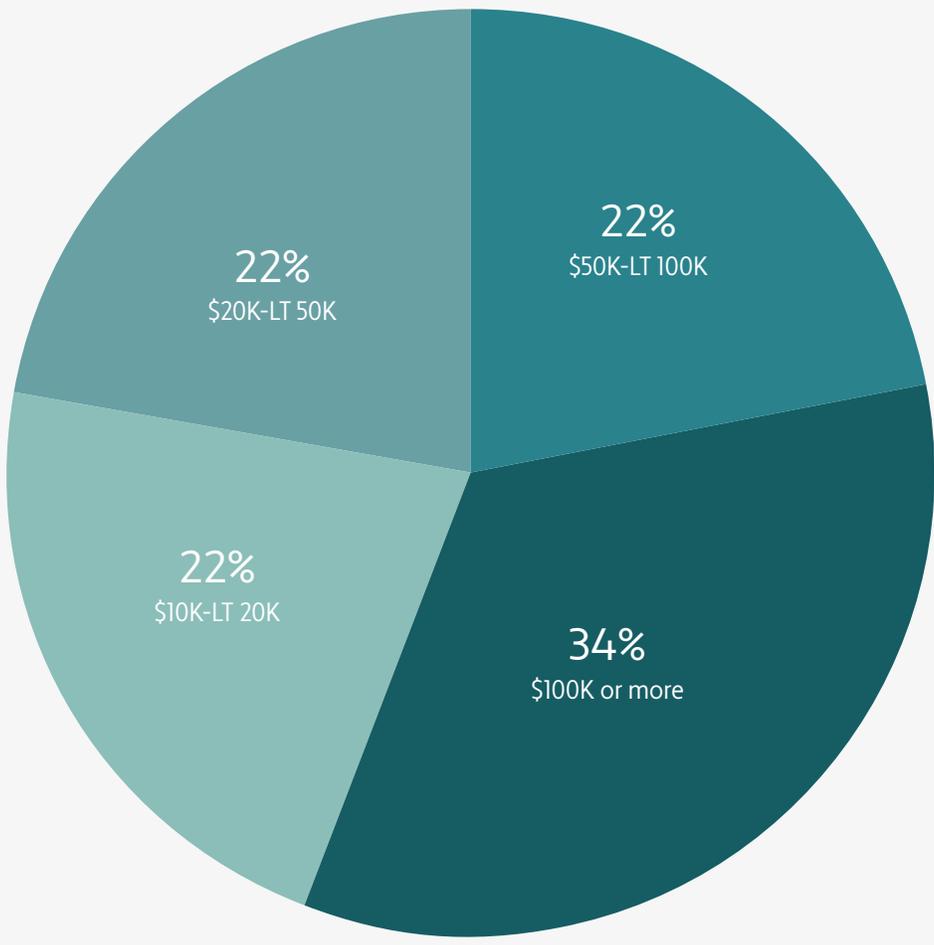
In your opinion, if your company were audited for sales and use tax today, how likely or unlikely is it that the auditor would find mistakes?



KEY TAKEAWAY: 75% of tax professionals believe a state auditor would find a mistake.

4 When your company was audited, approximately how much did it cost, in total, to manage that audit? This includes the amount paid in penalties and interest, fees paid to outside tax pros, man hours lost producing necessary documents, etc.

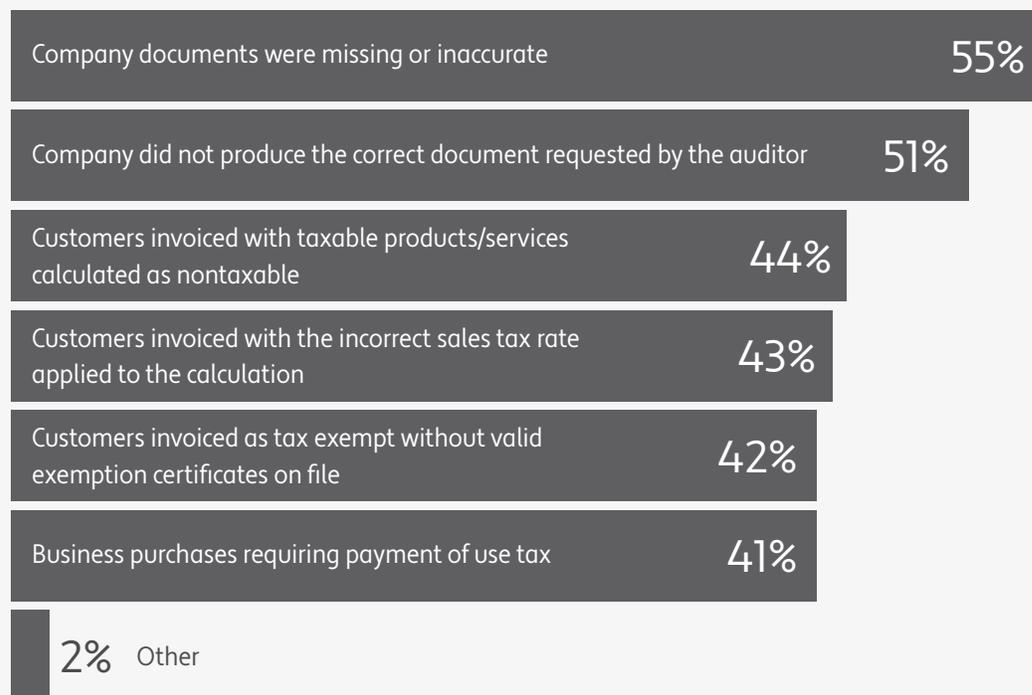
(Asked among those who have been audited)



 **KEY TAKEAWAY:** Average cost of an audit is \$301,496

5

Which of the following issues were identified during your company's audit?
(Asked among those who have been audited)



KEY TAKEAWAY: Over half of respondents had missing or inaccurate documents and/or could not produce correct documentation requested by a state auditor.

Nexus or Not? Knowing Where to Collect and Remit Sales and Use Tax is Confusing



Dispelling Nexus Myths

Despite familiarity and confidence relating to nexus, many accounting and finance pros believe these two myths:

- **41% believe it's the state's responsibility** to contact a company if nexus is presumed in that state.
- **38% believe** that what constitutes nexus is the same across all states.

Nexus (the physical and/or remote presence within a state that defines a tax obligation) is the 800-pound gorilla of compliance. Even the most seasoned tax professionals struggle to get it right. The reason for this might be because the rules that determine nexus are ever-changing and vary from state to state. At one time, companies could use a decision by the U.S. Supreme Court in *Quill Corporation v. North Dakota* (1992) as a guideline. In that case, it was simple: States could not require companies to collect state sales tax unless those companies had significant physical presence, like a warehouse or storefront. But that has all changed.

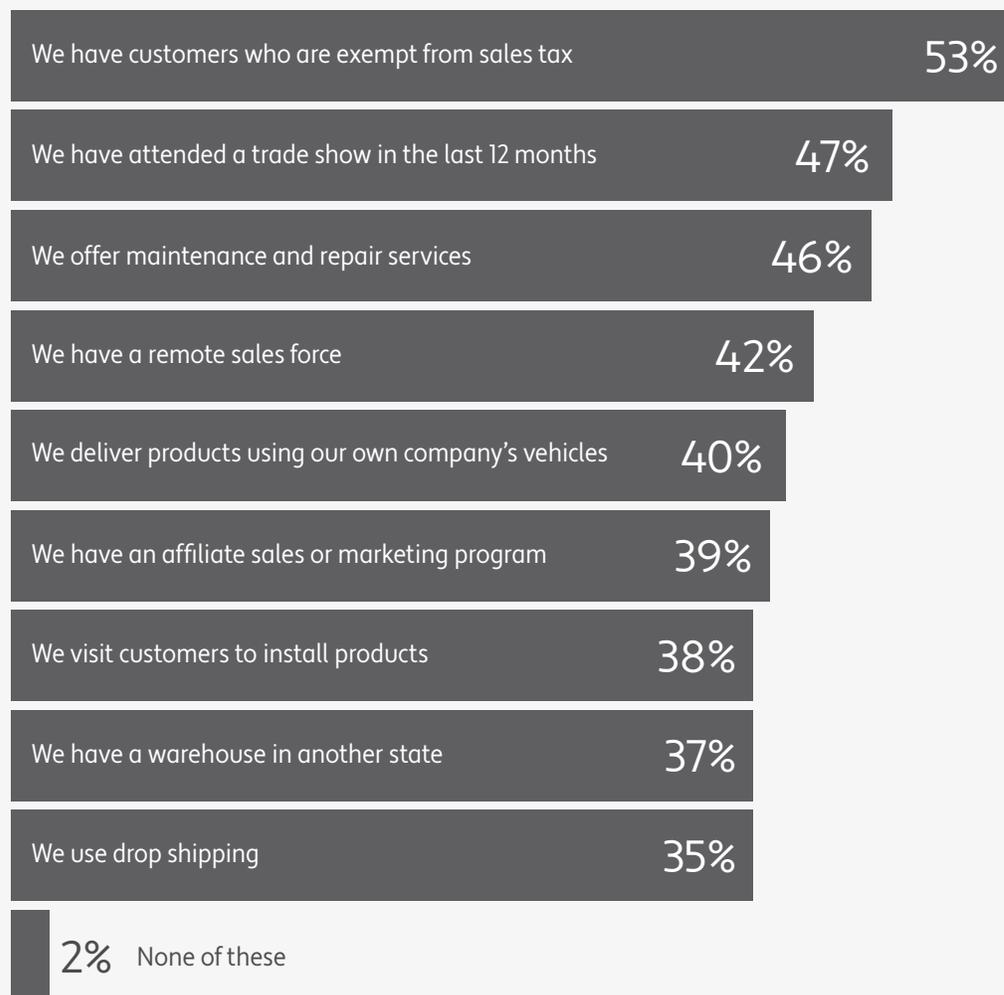
In 2017, many states have added newer forms of nexus, such as “economic nexus” and “click-through nexus,” to the mix as a means for revenue recovery. That creates even more tax planning problems and audit risk for companies.

According to the study, **94% of survey respondents have misconceptions around what creates nexus**. By itself, that’s not surprising or alarming but **98% of the same respondents are doing one or more of the types of activities that create nexus in many states**.

Research also shows that 31% of companies don’t know or can’t confirm a routine process for assessing their nexus obligations, even though **the majority of respondents (61%) are registered to collect sales tax in multiple states**.

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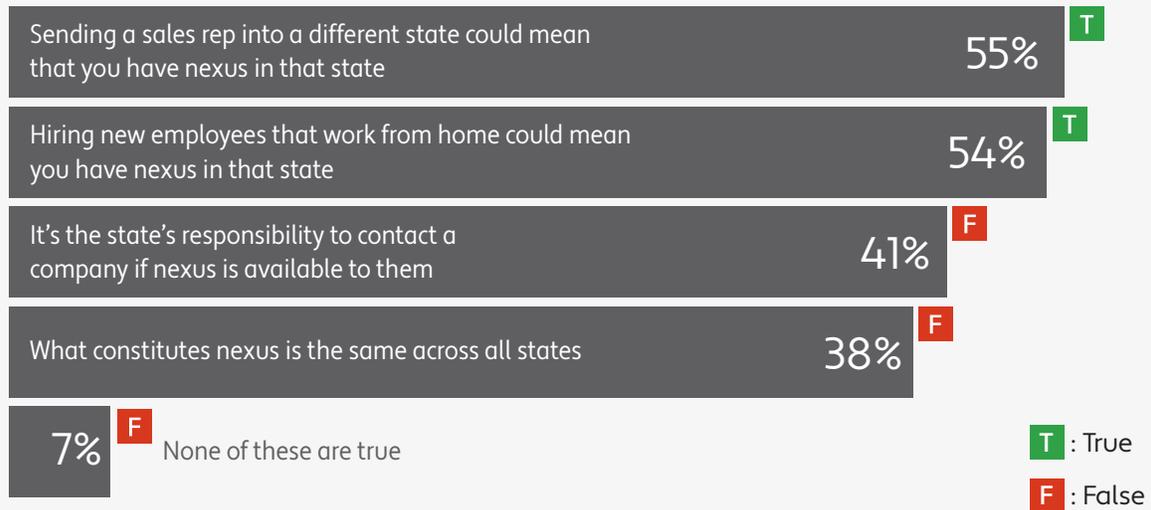
Which of the following practices or policies, if any, apply to your company?



KEY TAKEAWAY: 98% of companies surveyed are involved in one or more nexus creating activities.

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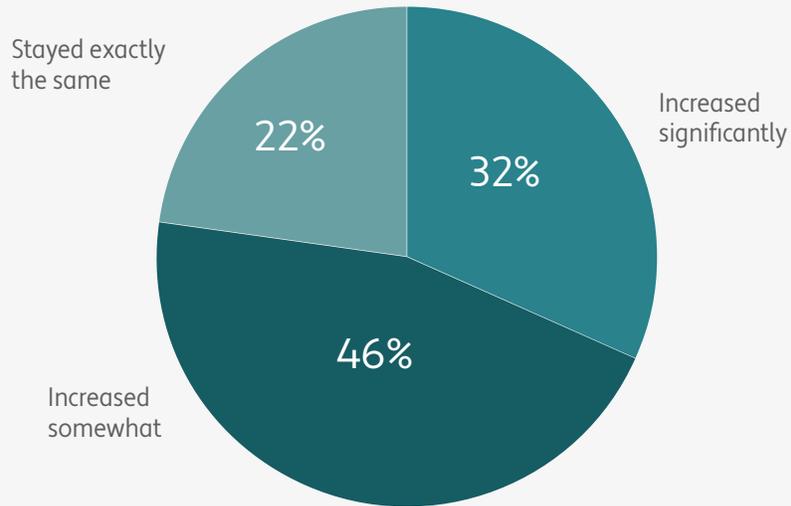
Which of the following, if any, do you believe to be true about nexus as it relates to sales and use tax?



 **KEY TAKEAWAY:** 94% have one or more misconceptions about how nexus is created.

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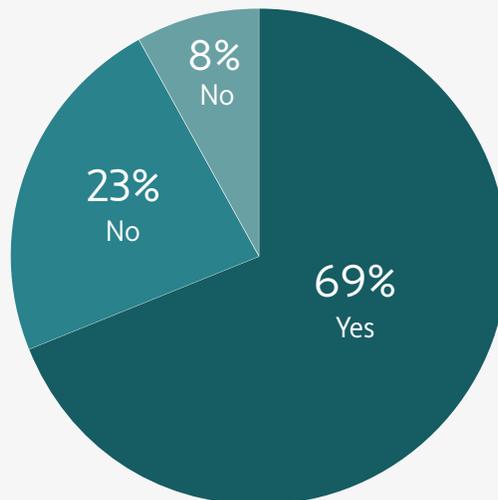
Have your online sales increased or decreased in the past 5 years?



KEY TAKEAWAY: 78% of companies surveyed have increased their online sales in the past five years.

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Does your company have a routine process for keeping track of and assessing its nexus?



Bring in the Calvary! More Bodies Needed for the Same Job



The Compliance Equation: More Complex = More Time

Compared to five years ago, [63% of companies spend more time](#) on sales and use tax compliance.

One of the biggest trends since the original study done by Wakefield Research in 2014 is the increase in staffing needed for tax compliance related activities. On average, **companies surveyed have six people (up by four since 2014) dedicated to sales and use tax management.**

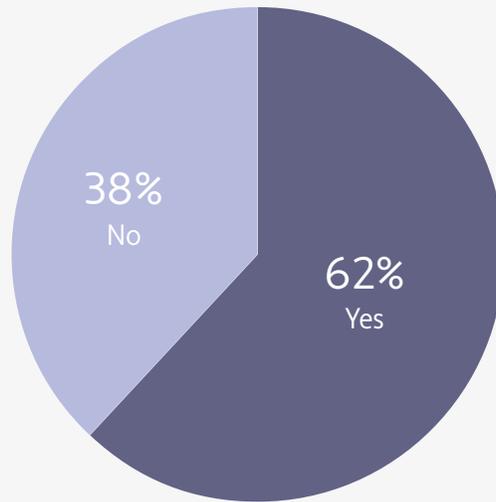
While most CFOs and finance leaders would agree that any measure to offload tedious, non-value-add tasks, is worthwhile, sales tax is still a predominantly manual task. And for many, it's getting even more manual. According to the research, **62% of companies surveyed have hired additional staff to manage sales tax within the last five years.**

The additional staff would indicate a shorter turnaround on compliance related tasks, but compared to 2014, the **average time spent on indirect tax compliance increased by over 250%.**

Companies aren't getting less adept at compliance, and they're clearly investing in the resources to manage their business, but the volume of tax rates and product/service taxability rules is outpacing many companies' ability to keep up. In fact, **95% of respondents agree that understanding sales and use tax has gotten increasingly more difficult in recent years.** Which tasks pose the greatest burden? Respondents indicated the following: complexity and concern over getting audited, lack of consistency/continuously changing rules, administration and time it takes to complete tasks, financial cost to the business, and amount of paperwork that must be completed.

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Has your company hired new staff members specifically to manage the increase in time spent on sales and use tax compliance?



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How many accounting professionals, if any, does your company have dedicated to managing sales and use tax compliance?

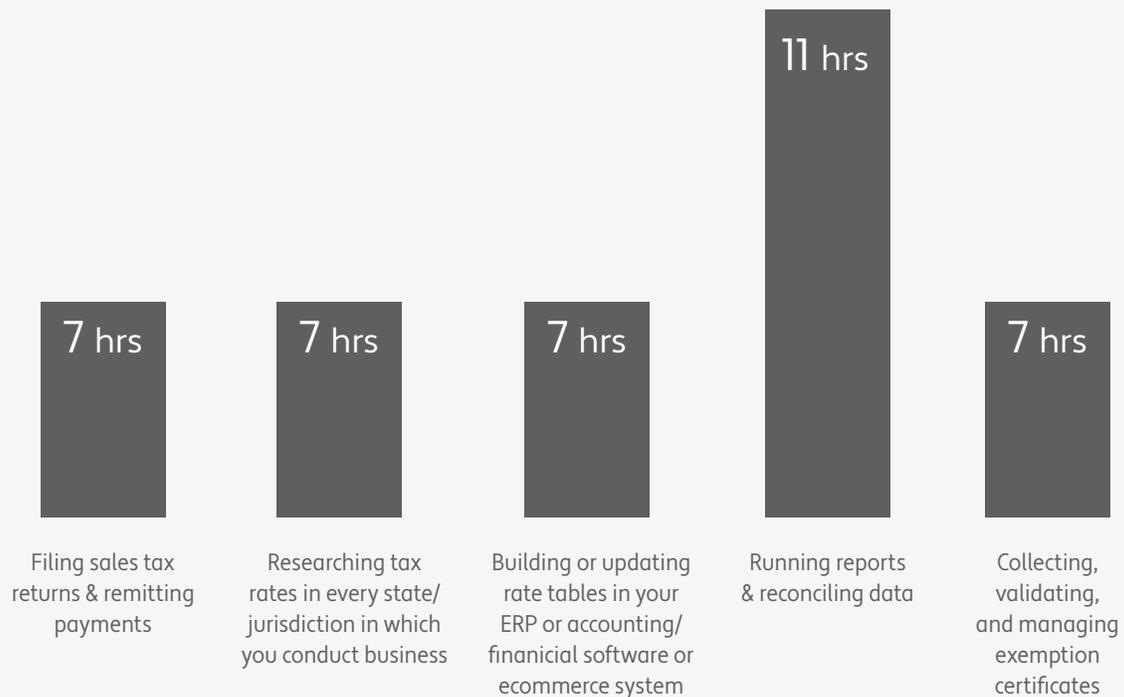


 **KEY TAKEAWAY:** Average (accounting professionals): 6

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During a typical month, approximately how many hours do you spend on the following:

Average hours



KEY TAKEAWAY: Companies devote on average a total of 39 hours per month on sales and use tax compliance related tasks.

Wrong Tool for the Right Job: Outdated Compliance Strategies Are Still the Norm



Filing Cabinets Are Antiques

43% of companies with an exemption certificate process in place use a filing cabinet or other hard copy storage to collect, validate, and store exemption certificates.

Nearly **23% have no system** in place to even manage their exempt sales.

Business-as-usual processes are not good enough. The data indicated two things: Many businesses don't account for sales tax rules correctly (especially companies that sell online and have tax obligations in multiple states) and the tools used to manage compliance are either outdated or not designed for the job at hand.

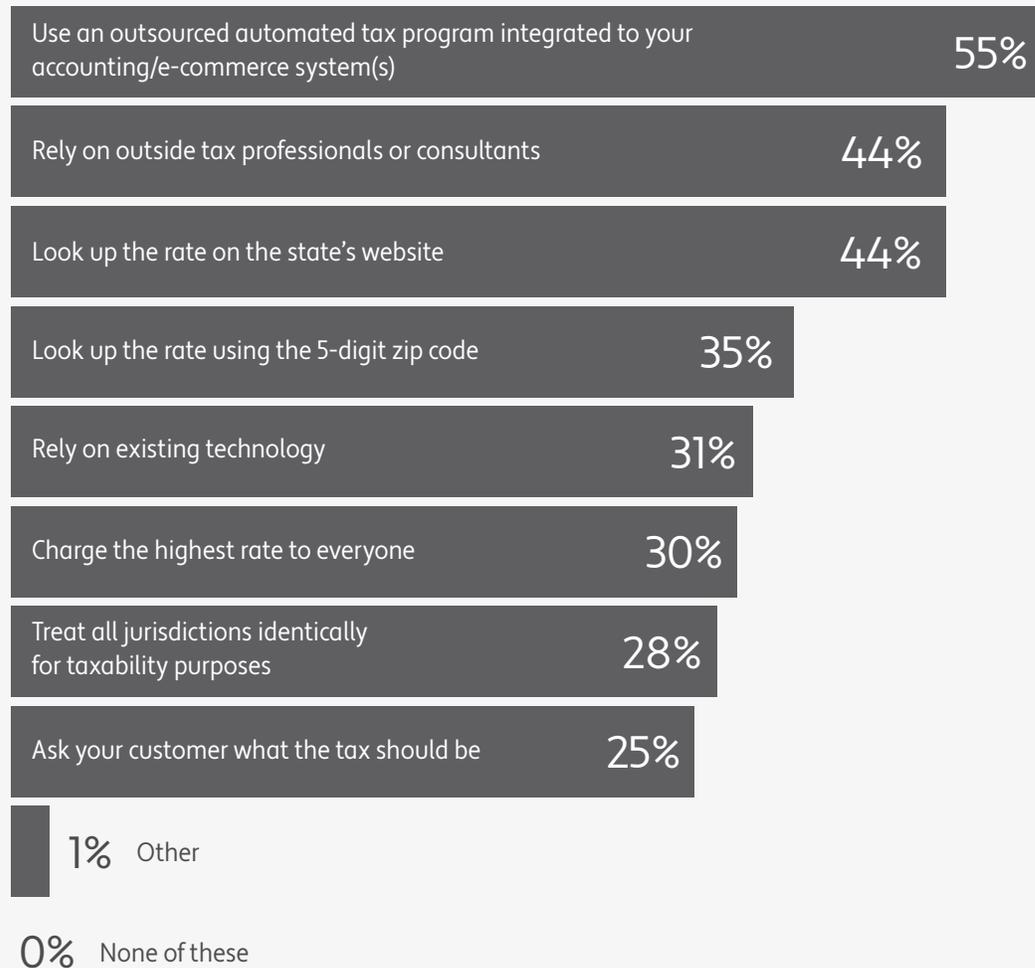
There were close to 14,000 changes to U.S. rates and jurisdictions in 2017, yet 31% of the accounting pros surveyed rely on "existing knowledge" to determine their tax liabilities. In fact, exactly half of the respondents haven't updated their sales tax compliance processes in over six months or couldn't remember when they were last evaluated.

One of the prevailing methods for determining tax rates is using zip codes (35%) and **nearly half of respondents still perform the tedious task of looking up tax rates on state websites.**

Moreover, 88% of companies do not use cloud-based automation to file and remit sales tax, while 38% use on-premises solutions that are supported and maintained by costly IT groups.

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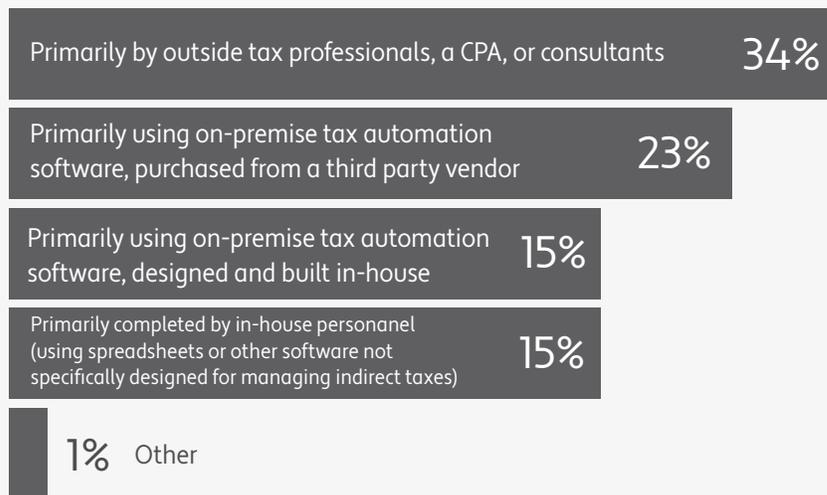
Which of the following methods, if any, does your company use to determine sales and use tax rates and taxability rules?



KEY TAKEAWAY: Nearly half of tax professionals research tax rates on DOR sites in all of the states in which they're registered

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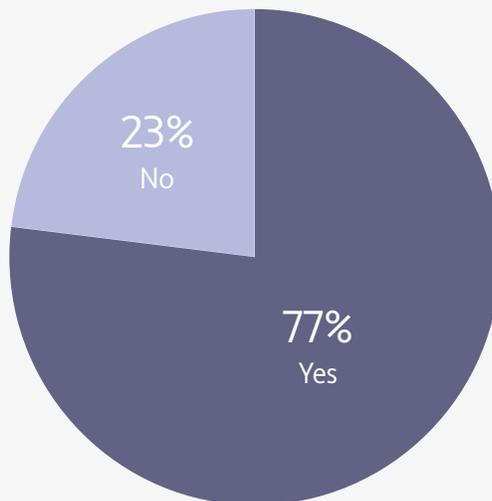
Which of the following best describes how your company's sales and use tax returns are prepared?



KEY TAKEAWAY: Not using cloud-based tax automation software (net): 88%

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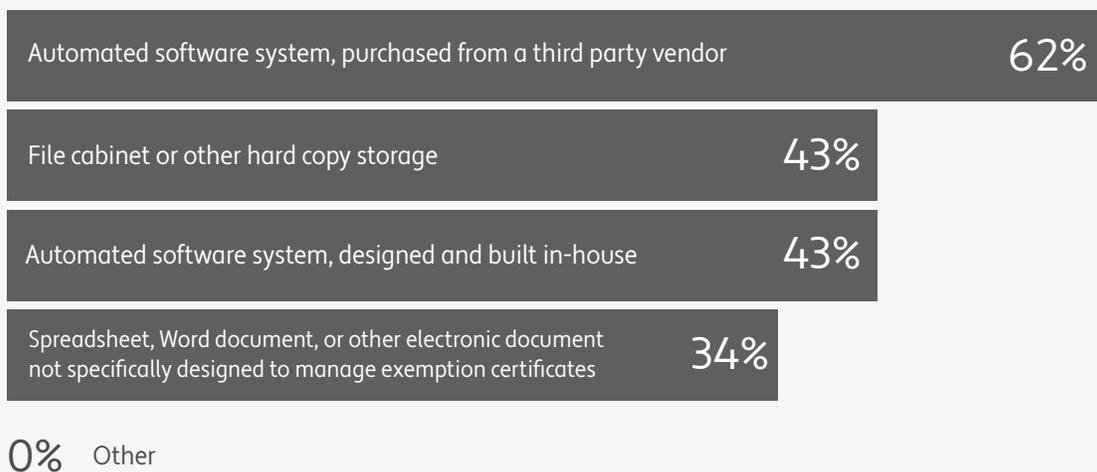
Does your company currently have a system in place to collect, validate and store exemption certificates for customers or clients who aren't required to pay sales tax?



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Which of the following methods do you use to collect, validate and store exemption certificates (including reseller certificates)?

(Asked among those who have been audited)



KEY TAKEAWAY: Nearly half of companies use a file cabinet or other hard storage for exemption certificates.

The case for automating sales tax management

There are over 16,000 taxing jurisdictions in the U.S., many of which are now requiring out-of-state companies across many industries to either collect sales tax and/or report use tax to its out-of-state customers for the first time. Even if federal legislation that effectively ends sales tax-free online shopping isn't passed, the influx of state rules and regulations will only make compliance more complicated. The solution? Automating the process with a cloud-based sales tax solution that resides within your business.

There's a reason automated solutions represent a cost-efficient and comprehensive solution to the ever-present risk of state audits. They are, in essence, a revolutionary change in a marketplace that has come to recognize a consistent process and predictable workflow for all transactional tax reporting as fundamental to any audit strategy.



Automation is the clearest and best method to graphically display policies and procedures for a competent and, most important, compliant system of sales tax reporting. Organizations can have peace of mind knowing their automated solution meets and exceeds the standards auditors expect from each business. Just as important, automated tax reporting can greatly diminish audit vulnerability, a best-case scenario for every business.

About Avalara

Avalara helps businesses of all sizes achieve compliance with transactional taxes, including sales and use, VAT, excise, communications, and other tax types. The company delivers comprehensive, automated, cloud-based solutions that are designed to be fast, accurate, and easy to use. Avalara's Compliance Cloud® platform helps customers manage complicated and burdensome tax compliance obligations imposed by state, local, and other taxing authorities throughout the world.

Avalara offers more than 600 pre-built connectors into leading accounting, ERP, ecommerce and other business applications, making the integration of tax and compliance solutions easy for customers. Each year, the company processes billions of indirect tax transactions for customers and users, files more than a million tax returns and manages millions of tax exemption certificates and other compliance documents.

A privately held company, Avalara's venture capital investors include Sageview Capital, Battery Ventures, Warburg Pincus, Technology Crossover Ventures, Arthur Ventures, and other institutional and individual investors. Headquartered in Seattle, Avalara has offices across the U.S. and overseas in the U.K., Belgium, Brazil, and India. More information at www.avalara.com