Taxing Matters:

WHAT ALL MANUFACTURERS SHOULD KNOW ABOUT SELLING ONLINE

What every manufacturing firm should know about indirect tax compliance and how to effectively manage B2B and B2C e-commerce transactions in the modern world.
INTRODUCTION

As businesses adjust to the “new normal” that’s been thrust upon them by the global pandemic, many manufacturers have either launched or enhanced their online sales channels. With consumers spending $347.26 billion online during the first six months of 2020 — up 30.1% compared to the same period in 2019 — manufacturers are putting more effort into digital transformation in an effort to harness both the B2C and B2B sides of their businesses.

The same companies are managing new tax requirements and compliance issues, both of which were originally spurred on by legal tax nexus decisions like South Dakota v. Wayfair, and that have become even bigger challenges during this period of rapid e-commerce growth.

In this report, we look at the quick pivots that manufacturers have made to online selling, show how these shifts have impacted their tax compliance requirements, and highlight how an automated tax compliance solution streamlines these activities, frees up valuable human resources, and keeps customers happy.

SHIFTING GEARS QUICKLY

Companies across all sectors were already investing in technology and digital transformation before the global pandemic reared its head in early 2020. Manufacturers were no exception, with many of them putting software, hardware, automation, robotics, and other technologies to use on their plant floors and within their distribution networks. The pace of adoption accelerated when shutdowns, quarantines, and the need for social distancing surfaced along with COVID-19.

Now, the same manufacturers are scrambling to get even more systems in place to support these shifts. And while the impacts are felt across their operations, manufacturers have been particularly strained by the upticks in both B2B and B2C e-commerce sales. No longer comfortable with the in-person selling environment, more customers are using screen taps and mouse clicks — versus brick-and-mortar visits and face-to-face sales calls — to procure everything from operating supplies to raw materials to basic necessities.
The proof is in the numbers: According to Adobe, the pandemic drove an additional $107 billion in online spending between March 2020 and September 2020. To grab their respective pieces of this growing pie, manufacturers have had to switch up their sales and distribution models. As a result, they’re now reaching broader customer bases (often in entirely new, previously untapped geographic regions), reducing the burden on their sales staffs, and streamlining their operations.

These quick pivots have also impacted manufacturers’ tax compliance processes. Those that weren’t braced for the quick changes now lack the controls and infrastructure necessary to effectively manage this complex tax environment.

According to a mid-pandemic McKinsey study, B2B companies now see digital interactions as two to three times more important to their customers than traditional sales interactions. In response, manufacturers are working to change their sales models in order to bypass traditional distribution channels, sell direct to consumers, enable B2B sales online, and tap into the power of B2B marketplaces, the latter of which offer channels for manufacturers that want to reach new customers in the competitive business environment.

McKinsey says other shifts that manufacturers are dealing with right now include the rise of remote sales (90% have moved to a videoconferencing/phone/web sales model); the need for more digital transformation and automation; a larger focus on developing resilient supply chains; and a renewed focus on prioritizing B2B customers’ needs.

“Even as they manage that reality, sales leaders also need to adjust how their organizations sell in the face of new customer habits and trying economic times,” McKinsey states. “In many ways, the changes in customer behavior are an acceleration of digital trends that were in motion before the pandemic hit. We believe we are at a digital inflection point, where B2B sales operations going forward will look fundamentally different from what they were before the pandemic.”

**B2B E-COMMERCE’S IMPACTS ON INDIRECT TAX COMPLIANCE**

Both manufacturers and distributors make direct sales to retailers or other distributors. Sales of products intended to be resold to consumers can be exempt from sales tax collection under a resale exemption. Since sales taxes are required to be paid by an end user or consumer,
the theory behind a resale exemption is simple:

The customer (consumer or end-user) will pay sales tax on the full retail price so when the reseller purchases from the manufacturer or distributor, it can be exempt from paying sales tax on that transaction.

Manufacturers have rapidly changed their go-to-market strategies and many are now selling online, but many businesses made these moves without considering the downstream tax implications. Prior to the South Dakota v. Wayfair case — and the related economic nexus rules, thresholds, and tax law changes — companies selling to customers nationwide from a single manufacturing facility (and no other regional locations or distribution centers) only had to register and file tax returns in their home state.

Now, the same company may have to register in 40+ states and collect and/or manage certificates from the majority of its customers. That’s because tax-exempt sellers must register in all states in which their transaction value or quantity exceeds nexus thresholds. Manufacturers could have passed one of these thresholds and be completely out of compliance and not even realize it, especially if they are selling online.

Companies also have to file tax returns with those states that account for the actual transactions. However, rather than collecting sales tax and remitting with the states, manufacturers must collect exemption certificates from all tax exempt customers (i.e. those in the supply chain), and have those available to prove to the state as evidence that the company was not required to collect sales tax. This creates audit risk for manufacturers.
During an audit, for example, a tax exemption certificate that’s invalid, out of date, or missing can put the company that hasn’t been collecting sales tax on the hook for that tax plus any late-payment penalties and interest. Further, many accounting and finance professionals believe that if a company fails an audit it is only obligated to pay back the erroneous transactions found by the auditor. In truth, penalties and fees can be applied to gross sales over a four-year period as an overall percentage.

To stay compliant, businesses must associate a tax exemption certificate for each non-taxable sale. Prior to the Wayfair ruling, businesses didn’t generally have to worry about exempt sales outside of where they had employees or physical buildings. Now, manufacturers must register and collect exemption certificates from hundreds, thousands, or even tens of thousands of customers. One national wholesaler, for example, went from needing just 500 certificates to now requiring certificates from over 5,000 customers. These massive increases simply cannot be properly managed using manual processes, phone calls, and spreadsheets, and they put undue strain on already burdened finance and tax teams.

**HOW MANUFACTURERS ARE SETTING THEMSELVES UP FOR SUCCESS**

The boom in B2B online sales and cross-border transactions driven by the pandemic caught some organizations off guard; others were set up for success. For example, Villa Verde, a manufacturer and distributor of garden products, set up its business for both B2B and B2C e-commerce.
When COVID reared its ugly head, the company was able to maintain both lines of business, even when its brick-and-mortar stores were forced to close. This multi-channel strategy helped Villa Verde hedge its bets in the face of the unknown, meet the needs of its customers, and shield itself against the next possible disruption.

But while many B2B transactions involving goods are tax exempt, the same isn’t true with B2C/D2C sales. The sales of most goods (and some services) are taxable in 45 states, with more than 12,000 different taxing jurisdictions using myriad different tax rates and rules. Add product taxability on top of that and things can get even trickier. For example, depending on where your customers are located and where you have a business presence (e.g., inventory, warehouses, employees), you may have to collect sales tax in multiple states.

These realities are putting new strains on manufacturers that don’t have automated, cloud-based systems in place to manage the additional workload. They also directly impact the customer that has to submit the right certificates or risk being taxed unnecessarily. According to a recent CFO.org poll, 57% of manufacturers see reducing the burden of exemption certificate management as a primary concern around tax compliance. For the manufacturer, this can quickly turn into a negative cycle of billing, rebilling, crediting, refunding, and adjusting — all of which can delay orders and hurt customer satisfaction.

Collecting, validating, managing, and storing exemption certificates in many states (vs. just one), means that most manufacturers have thousands of certificates to manage. Selling B2B online complicates the situation because the customer has to submit certificates upfront (or risk being taxed incorrectly), which creates major accounting issues and potential audit risk. The risks increase for manufacturers that are selling cross-border, and that are also managing VAT, GST, and other international taxes.

The reverse is also true, with EMEA, LATAM, and APAC organizations selling into the U.S. grappling with similar compliance requirements and economic nexus concerns as their U.S.-based counterparts. Using an automated tax compliance solution, these companies can enable online transactions, allow buyers to submit exemption certifications upfront at the point of the transaction, and simplify the buying experience for those customers.
CASH FLOW IS KING

The global pandemic has dramatically impacted all businesses, and manufacturing is not excluded. While some manufacturers are viewed as essential businesses in some states, others may not be, or may have been forced to dramatically alter their business because of slipping demand or state imposed shutdowns.

In this environment — and for the foreseeable future as the economic downturn spurred by COVID continues — cash flow is king, and these businesses want to get cash in the door. With Wayfair laws, the company that doesn’t have the right certificates on file, processing invoices and shipping goods could be delayed for days or weeks, thus delaying customer payment.

The other option is to process an invoice without the proper paperwork, but this puts the company at risk during an audit. If the company charges tax when it shouldn’t, the customer (who is also focusing on conserving cash), will dispute the bill and ask for a correction and rebill before paying any of it.

The problem is that most manufacturers selling B2B both online and through traditional sales channels are exporting data from different systems, feeding that data into spreadsheets, and then attempting to reconcile those documents against one another. Because their systems aren’t integrated or automated, this can result in a paper chase as companies scramble to stay in compliance. This is not only a huge drain on resources, but it also introduces errors and increases business risk (especially audits).
These and other challenges can easily be addressed with a cloud-based tax compliance solution that aligns with a manufacturer’s digital transformation efforts. Even better, these cloud-based technologies don’t lock manufacturers into using specific enterprise resource planning (ERP) or accounting solutions; they work across the entire finance tech stack, as well as with the company’s ecommerce/online selling platform or portal. This supports the omni-channel sales experience and ensures that everyone is working from the same playbook, and regardless of which platform he or she is using.

**EASE THE BURDEN WITH AN AUTOMATED TAX COMPLIANCE SOLUTION**

Avalara’s CertCapture automates the exemption management process by digitizing certificates. Because it maintains the certificates on a unified, cloud-based platform, CertCapture supports the paperless, work-from-home movement and provides 24/7 access to the authorized users who need access to these vital documents. With Days Sales Outstanding (DSO) being a key financial metric for all companies, automating tax exempt transactions with CertCapture can reduce DSO and help companies get paid faster.
An automated tax compliance solution also:

- **Enhances tax compliance efficiency.** Managing exemption certificates manually is inefficient, wasteful, and not a good use of human resources. South Dakota v. Wayfair adds an additional layer of complexity because businesses now need to collect exemption certificates everywhere they have economic nexus, and it can be overwhelming to manage the collection and verification of certificates when they are all on different forms and have various expiration dates.

- **Frees up employees to focus on more important projects.** Validating certificates is not a task that an intern can manage because he or she would have no idea if someone was using the right form. The process has to be handled by an experienced professional, and could potentially even be a full-time job in the post-Wayfair world. Avalara CertCapture allows manufacturers to offload that entire function and let their highly-trained staff work on projects that produce value for the company.

- **Improves the customer experience.** In today’s competitive business environment, manufacturers can’t afford to isolate customers over basic paperwork requirements, tax errors, and other technicalities. Without an automated system in place, manufacturers have to approach customers individually and request a variety of certificates. CertCapture uses automation to streamline this process and tie the certifications into an online order system/shopping cart/point of sale. It also allows customers to proactively manage their tax certificates. This helps to improve the customer experience, enable e-commerce, reduce errors, and attract new customers.

- **Allows companies to scale up quickly.** E-commerce sales are increasing rapidly right now, but collecting, managing, and updating certificates manually is inefficient and doesn’t scale well. Using an automated system, manufacturers can offload that functionality to a solution that also unifies disparate systems in an omni-channel environment.

- **Mitigates risk.** In most cases, auditors look first at how businesses handle tax exempt sales (i.e., does it have the certificates for these transactions on file?) and whether it properly handles consumer use tax. These are prime target areas for auditors, and CertCapture can handle in minutes reports that would take hours or days manually.
WHAT TO LOOK FOR IN AN AUTOMATED TAX COMPLIANCE SOLUTION

When shopping around for an automated tax compliance platform, look for one that stores all of your exemption certificates in one place. That way, in the case of an audit, the auditor will be able to access only those documents requested. Your platform should also sync with your transaction tax software to automatically apply tax exemptions to purchases (including drop shipments and purchase orders).

Your solution should also support remote access from anywhere and contact-free transactions (especially important in today’s world) and allow customers to submit exemption certificates during the actual online purchase process. This helps reduce shopping cart abandonment from the many different types of tax-exempt buyers and it can also open up new revenue streams for your manufacturing business.

Look for a solution that provides both exemption certification management and managed services. This is critical because if you’re simply collecting certificates, and not validating and managing those certificates, you could be setting yourself up for potential issues down the road. Finally, the platform should connect and consolidate management across all locations and business units, thus ensuring a completely integrated approach to tax compliance.

Named a leader in IDC’s MarketScape: Worldwide SaaS and Cloud-Enabled Sales Tax and VAT Automation Applications 2019 Vendor Assessment, Avalara’s cloud-based, end-to-end global tax compliance solution automates the resource intensive, manual processes associated with managing transaction and indirect taxes, including: tax-exempt sales and related exemption certificates, sales tax (calculation and returns filing), consumer use tax, cross-border (customs duty, import taxes, and item classification), VAT, and GST. Its exemption certificate management solution and related managed services can be used as a standalone solution or as part of the full tax compliance suite, depending on your business’ needs.

1 U.S. Census Bureau, https://www.census.gov/retail/index.html