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SALES TAX AND ECONOMIC NEXUS

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These days, anybody who sells goods or provides services to somebody outside of their home state should ask themselves, “Do I need to collect sales tax?” The correct answer is always, “Good question!”

However, the best way to get a useful answer is to start with a concept closely related to sales tax, namely “use tax.” Use tax is just like sales tax, except that it is not collected by the seller of a good or service.

Sales tax is collected by the seller and forwarded to the state, whereas use tax is paid directly to the state by the purchaser. Either way, the tax is owed by the “end user.” Typically, the seller will collect sales tax at the point of sale, make monthly payments to the state, and file a return every quarter, paying anything that wasn’t already paid the previous months.

In some cases, the seller doesn’t collect the tax, e.g., when a person has an annual garage sale or when somebody orders from a catalog (remember the Sears-Roebuck catalog?). In such

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cases, the buyer still has to pay the tax, called use tax instead of sales tax. In California, those who owe use tax can register for an account on the CDTFA's website and then file periodic use tax returns and pay online, or they can fill in a certain line on their CA income tax return and add the amount of use tax they owe to their total tax bill.

As you might imagine, very few people will keep track of the amount of, let alone pay, all the use tax they owe. There is a limit to how hard even the most law-abiding person will work to pay additional taxes.

State governments knew that getting people to pay use tax would be a great expenditure of money and effort to generate very little revenue. So, they began looking for ways to tax out of state sellers.

The states came up with a concept called economic nexus. If you do a certain amount of business in a state, the state decides that you have a presence in the state and are therefore required to collect sales tax on sales in that state. The states tried this many years ago (Did I mention the Sears-Roebuck catalog?), but the Supreme Court said, "No, a seller must have a physical presence in a state before that state can require the seller to collect sales tax."

Two years ago, the Supreme Court changed its mind. In the case of "South Dakota v. Wayfair, Inc.," the Supreme Court decided that each state could decide for itself if economic nexus was sufficient to require a seller to collect and pay sales tax and what that threshold was.

Now, each state has its own nexus. In the State of Washington, for example, the threshold for economic nexus is $100,000 in sales in the current or prior year[1]. If your customer is paying more than $100,000 for a shipment from you, then you must register with Washington's "Department of Revenue," collect the sales tax, and pay it in due course. Other states will have different nexus thresholds, and each state will tax a different mix of goods and services, all at different rates.

So, what you might have thought was a fevered dream that you might owe sales tax in another state is in fact a waking nightmare where you have to figure out if you owe sales tax in each and every state in which you have customers. What can you do about it?

As a trusted advisor, please reach out to us. We can help to determine what the nexus thresholds are in every state in which you do business. Act now, and that waking nightmare can be reduced to a significant inconvenience.

Source:

[1] https://dor.wa.gov/education/industry-guides/out-state-businesses

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