DIGITAL SERVICES TAX – A GUIDE TO THE CHANGING GLOBAL LANDSCAPE

CHAPTER 1

Practical considerations of implementing a global tax compliance strategy

If you are a digital business, there are now more than 80 tax authorities worldwide applying tax at destination. Legislative changes in the United States first introduced in 2018 allow individual States to levy sales tax on out-of-state vendors (including non-US vendors). This means that businesses will be paying more taxes to a growing number of tax authorities, year on year.

The changes are due to the rise of internet retail and a consequent fall in tax revenue from domestic bricks and mortar sales. To replace this lost revenue, tax authorities are increasingly moving to tax models based on the location of the customer rather than the physical location of the business selling.

This guide helps you understand the practical issues involved in in incorporating destination based taxation rules into your business operations.

CHAPTER 2
CASE STUDY

Vertex helps Ubisoft automate international indirect tax compliance

CHAPTER 3

US sales tax for digital service sales: A tax management guide

The United States has possibly the world's most complex sales tax regime. This is because each state sets its own sales tax rules, and states often take widely varying approaches. As a result, every state has a different tax framework, with variations in regulation covering everything from tax liability and tax rates to exemption categories and reporting requirements. On top of this, local area tax jurisdictions also have powers over some aspects of taxation and can set different rules for their area.

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WHAT YOU NEED TO KNOW

1) Determining customer location, and tax calculation

The starting point when calculating global VAT/GST/sales tax rates is to determine the customer's location so you know which rules and rates that apply.

- **Data required for this includes:**
- **Customer billing address**
- **Device IP address**
- **Bank details, such as the location of the bank account used for payment or the address of the customer held by the bank**
- **Mobile Country Code (MCC) of the International Mobile Subscriber Identity (IMSI) stored on the Subscriber Identity Module (SIM) card used where a customer orders by mobile phone**
- **Location of the customer landline through which the service will be supplied**
- **Credit card Bank Identification Number (BIN)**
- **Other commercially relevant information, such as a loyalty card or subscription numbers**
- **Zip code + 4**

But determining location can be less than straightforward. Some countries need only one piece of location evidence, others need two pieces of non conflicting evidence. In the latter scenario if the evidence conflicts, then in theory the customer location can't be determined.

An example would be where the customer billing address does not match the country of the device IP address, which in turn does not match the issuing country number of the BIN on the credit card. In these cases, self-declaration - i.e. allowing the customer to confirm their location - may be required. It is also key that you define a logic hierarchy for evidence collected, this hierarchy is extremely important where pieces of evidence are conflicting, e.g. always prioritise payment information where conflicting evidence arises. Whatever method you choose, it's important to avoid any disruption to the customer journey.

Everything must happen quickly and seamlessly, so the customer isn't kept waiting during checkout.

Key considerations

1. Customer location determination is integral to digital service VAT/GST calculation, but evidence collection can conflict and in turn disrupt the customer's purchasing journey.
2. A consistent approach to determining customer location will provide peace of mind that you are always applying the correct tax rule.
3. Friction-free tax calculations must be made in milliseconds to give a smooth customer experience with no delays during the checkout process.

2) Understanding tax thresholds

Your liability for paying consumption tax on digital services in each country will depend on the threshold set by the taxing country.

Examples of the varying thresholds currently in operation around the world include:

- **No threshold for any supplier -** Serbia, Russia, and Albania currently have no threshold. This means that you must register and file from the first sale you make in these regions.
- **Threshold only for micro-businesses -** the EU introduced a €10,000 (approx. USD$11,747*) threshold for micro-businesses established in the EU.
- **No threshold for a foreign supplier -** sometimes there is only a threshold for domestic businesses, with no threshold for foreign suppliers, e.g. Bahrain, Saudi Arabia, UAE, India.
- **Threshold issued on global sales –** e.g. Switzerland, which uses a global sales figure of CHF 100,000 (approx. $108,461*), i.e. if you have global sales over this figure you are liable for tax in Switzerland from your very first sale.
- **Thresholds that depend on both the value of sales and the number of transactions –** e.g. in the United States, a trend of a threshold of $100,000 in sales and/or 200 transactions at state level is emerging but is not consistent across every state.

*Note: Foreign exchange calculations from 11:55am on Friday, August 13, 2021, using xe.com

Key considerations

1. The rules are constantly evolving, this requires resources to monitor.
2. Sales analysis must happen per region on an ongoing basis, as tax thresholds may be breached with growing sales.
3. Just one sale could be enough to make you VAT/GST liable.

3) Applying foreign exchange (FX) rates

It's vital that you apply the correct foreign exchange rate for both invoicing and filing. As you might suspect, this is less than straightforward. It's not possible to apply a single exchange rate source across all countries; instead each tax jurisdiction dictates which exchange rate source must be applied. This in turn means you need a robust system capable of ensuring the correct source is selected for each jurisdiction. Furthermore, you need to define at what time the FX rate should be applied, at the time of the transaction, the time of the invoice or the end of the reporting period.

Here are some examples of FX rate sources that must be used in these specific jurisdictions:

- **Bahrain:** The rate changes are notified by the publication of laws in the official gazette, the source is the website of the Bahrain Tax Authority.
- **European Union (E.U.):** The FX rate source is provided by the European Central Bank (ECB).
- **Norway:** a weekly FX rate is set by the Norwegian Customs Authority.

Key considerations

1. There are multiple possible sources of FX rates.
2. You must apply the FX rate from the source dictated by each taxing jurisdiction.
3. Your systems must be capable of sourcing the correct rate for each jurisdiction.

4) Compliant invoicing

Each country's tax regulations include invoicing rules. In some countries these rules are simple - in Australia, for example, no set invoicing requirements are imposed, you may follow the invoicing rules of the country where your business is located. However, other countries insist on more complex invoicing rules, and any rule that applies to an invoice also applies to a credit note.

The most common and basic invoicing rules include:

- **Specific date formats**
- **Sequential invoice numbering per country**
- **Display of tax amount**
- **Indicative foreign exchange rate on tax amount**
- **VAT/GST registration number**
- **Business-to-business transaction information, i.e. required for countries implementing the reverse charge rule for business-to-business (B2B) transactions**

More unusual invoicing requirements include:

- **Bilingual invoicing** e.g. Saudi Arabia requires both Arabic and English, Serbia requires Serbian and English.
- **Uniform Invoice lottery** e.g. Taiwan will introduce the 'Uniform Invoice lottery' to digital sales from foreign companies on January 1, 2020. All online sales made within the country must then contain a 'legally generated lottery number' which each customer can use to enter the state lottery. The aim of the initiative is to encourage people to request an invoice, in turn leading to higher tax collections.
- **Signature of the authorised representative** e.g. India and Belarus require a company to issue an invoice containing the signature of a senior authorised representative of the company.
- **Identifying the tax agent on the invoice -** in countries where a tax agent is required, the invoice may require the details of the agent showing them as liable for the tax relating to that sale.
- **Albania has introduced e-invoicing**
- **Service Accounting Code -** India assigns a unique 'service accounting code' to each OIDAR (Online Information and Database Access Retrieval) service category, which must be shown on the invoice.

Key considerations

1. The lack of consistency in invoicing rules makes compliance complex.
2. The complications applying to invoices also apply to credit notes.
3. Important to recognise the implications invoicing can have for your business customer (e.g. the recovery of VAT).

5) B2B sales validation / United States tax exemption certificates

There are many tax jurisdictions that apply a reverse charge rule to business-to-business (B2B) sales transactions. Essentially this means the seller will not charge VAT/GST on the invoice as the recipient will self account for this tax. There are also markets that apply an exemption certificate e.g. the United States. These exemption certificates apply depending on the status of your business or the reason for the purchase.

You may think a reverse charge system simplifies your tax obligations as there's no need to charge and collect VAT/GST on sales to business customers. In practice, this isn't the case, because it's down to you to ensure the customer is a valid business when invoicing.

The complexities of B2B validation are confusing for suppliers selling business services, i.e. what is a business for VAT purposes and what is legally a business? The rules differ per tax jurisdiction. It is key to understand that sometimes a small company cannot be a business for VAT purposes while an individual can be a business for VAT purposes. As a result, some suppliers selling business services decide to assume that every customer is a valid business for VAT purposes and that the reverse charge rule will apply.

This is risky, and may leave you liable for the VAT not charged for being unable to prove customers' VAT business status when challenged at audit. Other suppliers take the opposite approach, and simply charge VAT/GST to every customer.

Here are just some of the issues to consider if your transactions include B2B sales:

- B2B validation can be completed through an API to a database in the relevant country that validates the business based on a business tax number. However, not all countries apply the same processes, and often there is no open access to validation databases.
- In the United States, you need to collect tax exemption certificates from tax-exempt customers. There is no uniform system for these tax exemption certificates and managing them effectively can be challenging.

Key considerations

1. Automated B2B validation processes vary in different countries; not all regions offer open access to validation databases.
2. The onus is on you to prove that your customer is a valid business for VAT/GST purposes.
3. If you sell in the United States, you need to collect tax exemption certificates from customers.

6) Data storage

Transaction data must be kept securely, and you must be able to access this storage if required during an audit.

Requirements vary across jurisdictions as to exactly what data must be kept and how long it must be retained.

For sales to EU customers, for example, the following information must be stored for 10 years:

- Country to which the service is supplied
- Type of service
- Date of sale
- VAT rate applied
- Amount to be paid in local currency
- Date and method of receipt of payment
- Invoice

For sales to EU customers, for example, the following information must be stored for 10 years:

- Bahrain: 5 years
- New Zealand: 7 years
- United States: data storage rules vary from state-to-state but there is a trend emerging of an average storage period of 7 years.

Key considerations

1. You must keep transaction data for potential audit purposes securely.
2. You must ensure you retain the transaction data as specified per each taxing jurisdiction.
3. Time limits for data storage vary on a country-by-country basis and in the United States on a state-by-state basis.

Where do you go from here?

As your business grows and develops, you don't want to be restricted by tax compliance requirements. Your focus should be on growing your sales. To make the most of global opportunities, you want to be able to sell to anyone, anywhere, anytime – and to do so in a way that is compliant and hassle-free. It is important to understand your business needs and consider how you can handle some of the following areas.

Keeping business friction-free

You want the solutions you choose to support destination country tax challenges to deliver both friction-free customer experiences and friction-free internal processes. This means that in addition to covering the day-to-day transactional issues, you must also be prepared for changes at short notice – which happen frequently. When you incorporate tax compliance into the digital sales process, the customer journey must stay as fluid as possible, yet still allow you to collect all the information required by the customer's home country tax authority. Whatever technology you use, it must be capable of handling validation checks and foreign exchange calculations without adding any delays or barriers that might put the sale at risk.

Compliance resourcing

Because of the enormous variety of requirements across the various tax jurisdictions, compliance management can be a substantial drain on resources. It's no surprise that many businesses resort to tax advisors, despite the substantial costs involved. It is important to evaluate not only your current business position and sales regions but also how quickly your sales are growing. Rapid global sales growth may affect your compliance requirements sooner than you think.

Keeping systems up to date with tax rates and rules changes

Though rules and rates are constantly changing, tax authorities don't always consider the need to give businesses adequate time to update systems, processes or resourcing to manage these changes effectively. For example, India introduced its digital tax legislation on 10 November 2016 to go live by 1 December 2016. Tax rates can be changed quickly too, e.g. Greece raised its VAT rate from 23% to 24% in June 2016, with one week's notice. Where a rate increase occurs and systems can't be updated in time, businesses must pay the extra tax amount due without being able to collect it from customers. Having an agile process to allow your business to adjust quickly and easily to these changes is essential.

Proactive Global Sales Reporting

Proactively managing global sales reporting will mean that you will never be caught off-guard by surpassing tax thresholds and unknowingly exceeding the threshold where you are required to register for tax in that jurisdiction. Evaluating sales at one point in time for liabilities gives you just that, tax liabilities for that point in time. Ongoing sales monitoring provides you with key business intelligence that can aid crucial

Managing global digital consumption tax compliance is not a 'one-size-fits-all' process. Every business is different, with its own unique requirements. Vertex partners with you to understand your needs and objectives. We then work closely with your team to design a practical, global digital consumption tax compliance strategy to deliver your goals.

CHAPTER 2
CASE STUDY

Vertex helps Ubisoft automate international indirect tax compliance

About Ubisoft

Ubisoft is a leading creator, publisher and distributor of interactive entertainment and services, with a rich portfolio of world-renowned brands, including Assassin's Creed®, Far Cry®, For Honor®, Just Dance®, Watch Dogs®, Tom Clancy's video game series including Ghost Recon®, Rainbow Six® and The Division®. The teams throughout Ubisoft's worldwide netwwork of studios and business offices are committed to delivering original and memorable gaming experiences across all popular platforms, including consoles, mobile phones, tablets and PCs.

Award-winning and phenomenally successful, Ubisoft is continually recognized for its innovation and responding to its customers' voracious appetite for gaming content.

The Challenge

Selling its gaming products and services to an increasingly global digital audience meant that Ubisoft needed to comply with a growing number of different tax obligations and liabilities in all the countries its customers make purchases from. As sales of Ubisoft's subscription model surged and its customer-base continued to expand into new international territories, indirect tax management was becoming increasingly time consuming.

A crucial requirement for Ubisoft was also to create a seamless experience for the customer at all stages of the purchasing journey. Ubisoft's tax collection and remittance process was tracked and managed via multiple systems alongside Excel spreadsheets - an approach that had worked effectively for a long time. But as the volume of international transactions increased, it was clear the existing system was going to become more labour intensive and an automated system needed to be implemented.

With each new country entered, each new threshold reached in different territories and compliance requirements in existing regions constantly changing, the finance team's valuable time was being eaten up by manual tax management processes.

Ubisoft recognized that managing these additional tax complications manually was not efficient. Françoise Thomas, Accounting Director, Ubisoft explains: "The games industry is booming and to continue to give our customers the very best experience we need to evolve our offering to meet their needs".

"Our new subscription model and success introducing our brand into new territories meant that our existing manual processes needed to be updated to efficiently manage future growth and business models. It was clear that we needed to find a way to streamline and automate indirect tax calculations and compliance on all sales."

Ubisoft Snapshot:

- A leading publisher of video games
- Customer type: B2C
- Geographical coverage: (Europe, Middle East, Asia)
- Company revenue: 1.53 billion Euros in 20

"We're a fast-paced, rapidly growing and evolving business and Vertex has answered our indirect tax management needs for automation, scalability, traceability and compliance."

Why Vertex?

Having at first considered building its own in-house tax solution, Ubisoft also decided to review the leading indirect tax solutions on the market. It was during this process that it discovered Vertex. From the outset, Ubisoft was impressed with the tax automation specialist's proactive approach to understanding its unique business requirements.

Vertex set itself apart from other third-party tax solution providers by demonstrating its understanding of the complexities of international indirect tax legislation, with a strong expertise on European tax rules. As international tax experts, Vertex fully understood Ubisoft's indirect tax challenges around sales of both digital and physical goods and was able to demonstrate how it could support this transactional process.

Vertex was also able to support Ubisoft's need for seamless integration with Zuora, the software behind its subscription model. Additionally, Ubisoft was impressed with the ease of use of the Vertex solution and the accessibility of the dashboard enabling real-time access to sales and tax data.

Françoise Thomas continued: "Vertex took the time to understand our business model and our indirect tax management challenges. As we expand into new territories, Vertex's expertise of the international tax landscape was invaluable. The Vertex team has been extremely responsive to our requirements from the outset and is a true business partner who works with us to support our current and future needs from a tax perspective."

Business Benefits and Outcomes

The Vertex solution now manages Ubisoft's international indirect tax compliance related to the EMEA zone . Streamlining and simplifying the process, Vertex applies customer location determination logic on each transaction as they happen.

The Vertex dashboard tracks and offers visibility of all tax threshold statuses and provides an audit trail of exactly how indirect tax is calculated in each country.

With real-time access to all its indirect tax management information in one central location, Ubisoft can archive all sales and tax information in the Vertex portal allowing for a comprehensive audit trail on all online sales. Vertex's seamless integration with Zuora enabled Ubisoft to go live with its subscription model very quickly. Now when a customer upgrades or downgrades their monthly subscription all indirect tax implications are automatically calculated as part of the purchasing process, meaning the customer experience is seamless.

Samy Toupet, IT Project Manager ERP, Ubisoft, said: "Not only is our business growing rapidly, our approach to delivering gaming content to our customers is evolving too. Vertex was able to quickly integrate into our eCommerce ecosystem to support our changing business.

"The automation of this entire process means that the finance team now has more time to work on other projects and deliver more value-add to the business. Vertex's dashboard gives us access to real-time sales data in one place and enables us to optimise our financial forecasting, planning, and reporting processes. We're a fast-paced, rapidly growing and evolving business and Vertex has answered our indirect tax management needs for automation, scalability, traceability and compliance."

Vertex Services:

- Real-time customer location determination
- Integration via API and with subscription-based services application, Zuora
- Automated indirect tax calculations for digital and physical items
- Simplified and streamlined international indirect tax management
- Archiving of tax data for audit processes

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If you sell digital services into multiple US states, what does this complex landscape mean for your day-to-day sales tax management?

In this guide, we explain key background information and discuss core compliance issues, so you can assess the practical implications for your business.

Nexus – the root of all sales tax liability

The requirement to pay sales tax (and use tax, more of which later) is rooted in the principle of 'nexus' – a connection with a state.

Historically, this connection has relied on a business having physical nexus, defined as a 'substantial physical presence,' in the state. The term can be applied differently by individual states, is open to interpretation, and is often extended in ways to include sellers of digital services based outside of a state.

Since the landmark US Supreme Court judgement in 2018 in the South Dakota vs. Wayfair case, states have also been free to apply what's called 'economic nexus'.

With economic nexus, the connection to the state is established through levels of sales activity to customers within the state. The judgement followed a challenge by internet retailer Wayfair to the state of South Dakota, which had introduced economic nexus rules in early 2016. Wayfair's case was that economic nexus was unconstitutional. The Supreme Court disagreed, and ruled in South Dakota's favour.

As a result of the judgement, more and more states are now bringing in economic nexus rules. There is a pressing reason for them to do so: the growth in ecommerce has led to a sharp decline in tax revenue as purchases are increasingly made from 'remote sellers' – entities who make sales into a jurisdiction where they have no physical presence, and therefore no requirement to register for sales tax under physical nexus rules.

To put this into context, the US Government Accountability Office has estimated that in 2017, states could have recovered between 8 billion and 13 billion dollars if they had applied sales tax to sales made by remote sellers.

WHAT YOU NEED TO KNOW

Step 1 – Establishing if you have nexus

In assessing whether you have nexus in a state, it's important to look at whether your activities create either physical nexus or economic nexus (or both). The law does not require you to fall into both categories – either one is sufficient.

Step 1.1 – Establish where you have physical nexus

You might expect physical nexus as determined by 'substantial physical presence' to apply only to in-state sellers. Yet remote sellers of both physical and digital goods and services can also find they have physical nexus. This is because nexus can be created by a surprisingly broad range of activities, from downloading cookies to a customer's computer to paying people to help you establish and maintain a market in the state.

Each state interprets the rule in its own way. Some have strict definitions of what counts as physical nexus, others don't.

Physical presence

Physical assets in a state can create physical nexus. These may include office premises, employees based there (including home-based employees) or inventory either in the form of physical goods or servers storing digital assets.

Employee(s) travelling in and out of a state

It's easy to see how having an employee based in a state can create physical nexus. But did you know you can also create nexus if an employee simply visits a state on business? Whether or not the activity is sales-related makes no difference. The frequency of the activity is what counts – and (as always) each state has its own rules.

One of the strictest states in this respect is Michigan. Here, having an employee in the state for just a single day during a 12-month period can trigger sales tax nexus. Other states are a little more lenient. A good rule of thumb is that 3 or more days of travel in the state over a 12-month period will create physical nexus for sales tax purposes.

Working with 3rd party contractors in a state

Working with 3rd parties for tasks such as sales, training, implementation, repair or support services to clients can create nexus in the same way as having employees in a state. Nexus comes from the fact that the person is present in the state and performing the service on behalf of the out-of-state business.

'Cookie nexus'

Another tactic some states use to bring remote sellers within reach of physical nexus is to say that physical nexus is created when a seller's website installs cookies on a customer's device. These rules have been dubbed 'cookie nexus'.

Trade shows

Exhibiting at trade shows can be a route to creating nexus, though not all states have a ruling on this. Where rules do exist, they vary widely between states. Some states give thresholds for a number of days attendance or volume of sales at the event above which nexus will be created.

Two examples are California, with a threshold of 15 days attendance, and Massachusetts, with a threshold of just 3 days. To complicate matters further, some states say nexus is only created on sales at the event, others say that it is created for any sales resulting from the event, and others that it is created for all sales in a calendar year.

Online affiliate marketing – 'click-through nexus' or 'Amazon tax'

Click-through nexus is created where a remote seller business gives a referral fee or commission to an in-state business who sends customers to them via a direct website link. A typical scenario is an affiliate partnership where an in-state blogger promotes a product or service on behalf of an out-of-state or overseas seller.

Multiple physical nexus-creating activities

Nexus-creating activities aren't treated in isolation. States will typically combine activities to decide whether your activities are substantial enough to create nexus. A few days visiting potential clients, a day at a trade show and a day or two providing training at a customer site could be all that's needed to make you liable for sales tax in a state in any one year.

Key considerations

1. Monitor sales activity by state.
2. Understand the state-specific rules on sales revenue value, thresholds and calendar periods.
3. Monitor legislative changes.

Step 1.2 – Establish where you have economic nexus

It makes sense to start by looking at where you may have economic nexus. This is because it is the most likely of the two types of nexus to apply to remote businesses based outside the US.

There are only two aspects of business activities used to assess whether businesses have economic nexus in a state:

1. Sales revenue value
2. Number of transactions (if you operate a subscription model, note that every renewal counts as a transaction)

Some states use just one of these measures; others use a combination. There is no consistency between states as to the level of revenue and/or the number of transactions at which nexus is created.

A further complication is that individual states can potentially use three different revenue figures and periods for calculating sales revenue value.

Revenue figures can refer to:

- Gross sales revenue – all sales including tax exempt sales and exclusions.
- Retail sales revenue – any sale other than a sale for resale.
- Taxable sales revenue – only taxable sales, with tax-exempt or excluded tax sales not counted.

The period for calculations can be:

- Previous 12 months
- Current calendar year
- Previous calendar year

Even if you don't yet meet the threshold in a state for economic nexus, business growth can, of course, mean that this changes at any time. It is therefore essential to monitor sales on a state by state basis at all times.

It is also vital to keep track of individual state legislative updates, as the situation is constantly changing. A useful resource is the Sales Tax Institute's Economic Nexus State Guide*.

Key considerations

1. Be aware that you may have physical nexus in a state even without an office location there.
2. For the states you sell into and where you do not have economic nexus, check whether your activities in each state could be creating physical nexus.
3. Take account of physical nexus rules when you plan both operational and sales activities.

*Please note that Vertex provides the link to the Sales Tax Institute Economic Nexus Guide for reference purposes only. We cannot take responsibility for the accuracy of the information. You should check all information with a sales tax advisor before implementing a sales tax strategy.

Step 2 – Determine taxability of products and services

Product level taxability refers to the classification of products and services to apply the correct tax rate. Individual tax jurisdiction can choose to exclude particular classes of goods and services from tax or provide a reduced rate tax to certain items. Traditionally, tangible personal property has been taxable unless specifically excluded, while services have been exempt unless specifically included.

But with the growth of digital products and services, states are struggling to define new technologies within their tax frameworks. Old definitions no longer make sense, but new definitions are often vague. Many states have no clear definition of where or how sales tax applies to digital products or services. And with cloud-based sales – such as software as a service – the picture changes again, with states taking a wide variety of different approaches.

To add to the complexity, although product level taxability rules are in most cases set at the state level, local jurisdiction within states can also apply differing rules. This means in some states, a product or service category can be taxable at the state level and not at the local level and vice versa.

Key considerations

1. Understand exactly what you are selling: what are the sales processes involved, and how do customers access the product?
2. Take professional advice as to how your product/service matches product classifications in each state where you have nexus – not all states publish comprehensive lists, and definitions typically require some level of interpretation.
3. Monitor when new states start to apply sales tax to digital services.

Step 3 – Use tax notification and reporting

You may think that if you do not have physical or economic tax nexus in a state, you do not have any tax obligations. However, this may not be the case. You can still have legal obligations to the tax authority in a state even where you do not have nexus and are not required to collect and remit sales tax in the state.

The reason? Use tax.

Use tax is required to be paid by the buyer in cases where the seller does not collect sales tax. Use tax or sales tax is due on a sale, but not both. Therefore, use tax is a complementary tax and is not charged if sales tax was charged.

A number of states – including Colorado, Oklahoma, Pennsylvania and Washington and more – have chosen to offer remote sellers the option of complying with strict use tax notification and reporting requirements rather than registering for sales tax under nexus provisions.

In general, use tax notification and reporting laws require you to do the following:

- Tell customers on your website that use tax may be due on purchases where sales tax has not been collected.
- Include a notice with each applicable sale saying you didn't collect sales tax because you don't have nexus, and that use tax is due from the customer.
- Send an annual purchase summary statement to every affected customer (in some states, by 1st class post and separate from any other communication).
- Send an annual customer information report to each relevant state, giving customer names and addresses plus details about what each customer bought, when they bought it, and what they paid.

It is perhaps no accident that use tax notice and reporting regulations can be so onerous that voluntary sales tax registration may seem a more attractive option.

The individual states that have enacted use tax notification and reporting laws do (of course) apply different rules. Some states have a minimum threshold for the volume of business or number of transactions below which use tax and reporting rules do not apply. Some states apply basic rules to all vendors, but have a threshold above which greater notice and reporting requirements apply. Some provisions apply only to customers who spend over a certain amount in a given year.

State-specific regulations also include idiosyncrasies such as the Rhode Island rule that you must send a use tax notification to the customer 48 hours after the order has been placed, rather than after the sale has been made.

Key considerations

1. Check if any of the states you sell into require use tax notification, even where you do not have nexus.
2. Investigate the specific use tax notification rules in each of these states.
3. Evaluate your position in relation to sales tax versus use tax in these states.

Step 4 – The practical implications of selling into multiple US states

Given the wide variety of rules and the rapid rate of change, every business selling into the US faces practical compliance challenges. Here are a few to consider when looking at building your US sales tax approach.

Destination or origin-based sales tax rules?

As a remote seller, you will normally follow destination-based tax rules, meaning you must, in theory, apply the sales tax rules and rates of the customer's location. But there can be cases where remote sellers are seen to make sales within a state – for example, when goods are held in a warehouse in the state. In this case, origin-based tax rules apply. You must then collect and remit tax according to the rules and rates applicable at the business location.

Origin-based tax rules

Origin-based sourcing applies to intrastate commerce. When a seller ships from within an origin-based state to a destination within the same origin-based state, the sale is sourced to the origination point and sales tax applies at the origination point.

Destination-based/remote seller tax rules

Destination-based sourcing applies to interstate commerce. When a seller ships into any state from a location outside that state, the sale is sourced to the destination point and sales tax applies at the destination point.

Customer location determination

In the United States tax rates are applied at a ZIP code level. In many cases, this will mean that the 5-digit US zip code is used along with the product taxability code to determine the sales tax rate for a given transaction. For more accurate sales tax rates 'ZIP + 4' code can be used. This means that additional address details are supplied such as a street address, city, state and then address validation is performed to match the supplied address to the United States Post Office address database. This will result in a very precise address identification and so the relevant State and City taxes can be identified.

Tax exemptions and exclusions

Every state can apply tax exclusions on goods and services within their state. This means the good or service is non-taxable for all customers purchasing the item. However, there are further tax-exempt purchases. Tax exemptions can also be applied at the customer level as opposed to the product level.

To prove sales tax exemption, the customer must provide you with a tax exemption certificate.

You must then review the certificate for completeness and validity (and be able to prove that you have applied due diligence in the process). Once you have accepted a certificate, it is not necessary to validate every transaction by the certificate holder as the certificate can be valid from 1 year to several years. However, it is important to implement a system to track the validity of exemption certificates.

Exemption certificates generally fall into two categories:

1. **Use-based exemptions**

   Resale exemption certificates are the most common form of exemption certificate. As sales tax is charged at the point of final sale, goods and services bought for resale are often exempt to avoid double taxation. Industries where use-based exemptions commonly exist are manufacturing, research & development and teleproduction.

2. **Entity-based exemptions**

   Some entities that are not resellers of goods may also be exempt from sales tax. These include charities, churches and religious organizations, education organizations, government/political organizations, trade organizations, social welfare organizations and veterans' organizations.

3. **Multi-jurisdiction exemption certificates**

   Tax exemption certificates are generally state-specific unless the business has provided you with a multi-jurisdiction certificate covering the relevant states. There is as yet no US-wide exemption certificate; however, the Multi-State Commission has created a uniform sales and use tax certificate which many states are participating in. This means your systems must be able to handle both single and multi-state certificates.

Key considerations

1. Check your business situation as regards origin and destination-based tax liabilities.
2. Understand how location determination issues affect you and plan accordingly.
3. Establish internal processes for handling tax exemption certificates.

Step 5 – Reporting

Both the process of reporting sales tax and the detail of the information required varies from state to state.

Typically, reports need the following details:

- Sales per tax rate, at a per line item level
- Sales by product (or service) code, at a per line item level
- Geographic identifier – typically a state, county, city, zip code combination
- Gross sales amount
- Non-taxable or exempt sales amount including a reason (for example exempt for resale, exempt for manufacturing purposes, excluded from tax, etc.)
- Taxable sales amount

- Sales tax collected
- Specialty or reduced tax amounts
- Transaction specific details for reconciliation or audit purposes including invoice number, invoice date, customer number, customer name, etc.

Specific reporting requirements to consider include:

1. **Timing of returns**

   Returns are typically due either monthly, quarterly, or annually. But some states have more unusual frequencies, including semi-annual or occasional. In most cases, the higher the volume of sales, the more often you are required to file and pay, with some states requiring pre-payments. Due dates are also variable. The most common due date is the 20th of the month; it can also be the 15th, 25th or 30th or the last day of the month.

2. **Reporting for relevant tax jurisdictions**

   Where sales tax is not a flat rate across a state, returns must provide the relevant detail for each local tax jurisdiction. Tax reports need to be broken down to show how the sales tax is apportioned to the relevant tax jurisdiction. This can include:

   - State
   - City
   - County
   - Metropolitan area

   The relevant tax jurisdiction should be shown for each portion of the sales tax collected.

3. **Reporting exempt sales**

   When reporting sales tax, the normal approach is to use a "bottom- up" methodology – starting with the sales tax collected by product/ service code type and dividing by the applicable tax rate to determine taxable sales to report. Exempt sales are then either added to taxable sales or calculated as the difference between gross

Key considerations

1. Understand the reporting process in each of the states where you have nexus.
2. Assess how your systems can help you comply across the different states.
3. Review what resources you will need to manage reporting.

Planning your US sales tax strategy

Whether you are selling into the US from another country or an existing US business expanding sales into new states, planning for sales tax compliance has to be a key strategic consideration.

Things to consider:

- How will you keep on top of the increasingly complex and ever-changing legislation?
- What systems do you need to put in place to make sure you collect sales tax on online transactions where required and at the correct rate?
- How will you build reporting requirements into your processes?

Every business is different, with its own unique requirements: US sales tax compliance is not a 'one-size-fits-all' process.

Vertex partners with you to understand your needs and objectives. We then work closely with your team to design a practical sales tax management program to deliver your goals. Vertex can also support your expanding sales footprint with our scalable offering, to help you manage global VAT/GST compliance obligations.

To find out more about how Vertex can help you achieve your digital growth ambitions in the US while efficiently managing your tax commitments, please contact us today.

Vertex would like to thank Brian Greer from TaxConnex for his contribution to this eGuide.

Managing global digital consumption tax compliance is not a 'one-size-fits-all' process. Every business is different, with its own unique requirements. Vertex partners with you to understand your needs and objectives. We then work closely with your team to design a practical, global digital consumption tax compliance strategy to deliver your goals.

For more information, contact Vertex today at vertexinc.com/en-gb/contact-us

ABOUT VERTEX

Vertex Inc., is a leading global provider of indirect tax software and solutions. The company's mission is to deliver the most trusted tax technology enabling global businesses to transact, comply, and grow with confidence. Vertex provides cloud-based and on-premise solutions that can be tailored to specific industries for major lines of indirect tax, including sales and consumer use, value added, and payroll. Headquartered in North America, and with offices in South America and Europe, Vertex employs over 1,200 professionals and serves companies across the globe.

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