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DISCLAIMER
Tax rates, rules, and regulations change frequently. Although we hope you’ll find this information helpful, this report is for informational purposes only and does not provide legal or tax advice.
Introduction
Never have individuals, businesses, and governments worldwide been so interconnected and reliant on one another. A ship blocks a canal in Egypt and a shelf can’t be restocked in Ohio. A COVID-19 outbreak in a factory in Vietnam clogs ports in Los Angeles. Fires in California affect wine poured in Montreal. A dearth of truck drivers empties gas pumps in Britain as a global labor shortage stresses the world’s hospitality industry. The litany goes on.

Against this backdrop, and with an unpredictable virus hard on the heels, businesses must navigate a complex web of regulations and requirements to be in compliance, often across multiple states and countries. Governments worldwide are mandating the digitization of invoicing and tax reporting to reduce the tax gap; some are even working together to eliminate corporate tax advantages. Compulsory transparency is forcing businesses to up their compliance game.

Government regulations can be difficult to track and understand during the best of times, when there’s minimal geopolitical and commercial upheaval. In the current environment, with the pace of change accelerating, it’s extremely challenging for businesses of any size to keep up with adjustments to rates, boundaries, deadlines, and overall tax compliance responsibilities.

Our sixth annual tax changes report is born of the wealth of knowledge held by the tax compliance experts at Avalara. It surveys the key domestic and international tax policy developments of the day and explores emerging trends in taxation and compliance. Avalara is committed to ensuring tax compliance doesn’t interfere with the growth or success of your business.
Sales tax changes
Forces shaping business and sales tax compliance in 2022

Sales and use tax compliance in 2022 will be shaped by numerous factors, including ongoing supply chain and labor challenges. Both are contributing to higher transportation and labor costs, which in turn can inspire businesses to seek alternative suppliers and products. Companies could also continue to allow or require employees to work remotely in 2022, which can create tax obligations in states and cities where employees reside.

Many businesses selling into the U.S. will continue to feel the effects of South Dakota v. Wayfair, Inc., the 2018 U.S. Supreme Court decision that enabled states to tax out-of-state sales and sparked a slew of economic nexus and marketplace facilitator laws. With the exception of Missouri, which will follow suit in 2023, all states with a general sales tax now require certain out-of-state retailers and marketplace facilitators to collect and remit sales tax. The particulars of each state’s requirements can be especially challenging for small businesses with few resources to devote to sales and use tax compliance.

Digitalization is another force that will increasingly affect tax compliance in 2022. By mandating electronic invoicing, digital filing and reporting, and more, governments worldwide are gaining greater insight into sales data. The information they acquire can be used to target enforcement activity and reduce the tax gap.

Under these and other changes lies the pandemic, which continues to disrupt business and tax compliance in unpredictable ways.
The long tail of COVID-19

We can’t stop talking about COVID-19, much as we might like to. Two years after the initial outbreak, it remains the primary disrupter of the global economy.

What the numbers tell us:

The top three risks to growth in 2022:

- THE PANDEMIC
- SUPPLY-CHAIN DISRUPTIONS
- INFLATION

96% of midsize businesses and 65% of small businesses have changed in response to COVID-19 (e.g., company vision, new products, staffing modifications, supply chain adjustments)

In 2020, the greatest shift to online shopping was by consumers in EMERGING ECONOMIES

Offline (in-store) sales surged by 22.3% in Q2 2021, the highest recorded growth for this channel, as newly vaccinated shoppers flocked to stores

Sources:
- McKinsey & Company
- Umpqua Bank
- United Nations News
- Digital Commerce 360
What the numbers tell us (continued):

Nearly $1 in every $5 spent on retail purchases in Q2 2021 came from digital orders.

COVID-19 accelerated the shift from physical stores to digital shopping by roughly FIVE YEARS.

Source: TechCrunch


Source: eMarketer

$1.14 T
Sales through all channels reached $1.14 trillion in Q2 2021, the highest year-over-year growth on record.

Source: Digital Commerce 360

23.9%
Digital sales accounted for 23.9% of all gains in retail spending across all channels in H1 2021.

Source: Digital Commerce 360
When the coronavirus first hit, businesses struggled to cope with mandatory restrictions, teleworkers grappled with how to work while overseeing homebound children, and governments explored tax-relief options.

The situation is different today, but the pandemic is no less impactful.

Businesses now struggle to fill positions and stock shelves while exploring how to safely bring people together in the workplace. Many COVID-19 tax relief programs in the U.S. have expired and aren’t likely to be renewed.

How the kinked supply chain is impacting commerce

The supply chain is stretched to near breaking due to heightened demand, staffing shortages, factory closures, clogged ports, and other factors. Ships often must quarantine for a week before they can dock in China, and on November 9, 2021, a record 111 ships waited off the coast of Southern California for a spot to unload. According to Naveen Jaggi, president of retail advisory service JLL, “Many retailers don’t expect any sense of a balanced supply-chain recovery until the summer of 2022 or even later.”

With demand outstripping supply, transportation costs are soaring. For example, shipping container rates from China and east Asia to the U.S. reached $20,000 per 40-foot container in September 2021 – up from about $4,500 in September 2020. The spot price for shipping a container from Shanghai to New York jumped from roughly $2,500 in 2019 to almost $15,000 in September 2021. And global
container prices were $10,525 for the week ending November 5, 2021, up from $1,238 on October 25, 2019.

This ongoing problem is so great the Biden-Harris administration created a Supply Chain Disruptions Task Force last summer. In October, President Biden met with the heads of FedEx Logistics, United Parcel Services (UPS), Target, Walmart, the Port of Los Angeles, and others to discuss “global transportation supply chain bottlenecks.” The companies pledged to work around the clock to help solve the issue, though labor shortages could make that challenging.

Faced with this untenable situation, some companies reinstituted purchase limits on certain high-demand products during the fall of 2021. Others are chartering their own container ships to ensure their goods will make it across the sea. And some are developing new supply chains or expanding their own storage capacity: DHL is increasing the square footage of its U.S. distribution centers by 70% to help reduce shipping times and keep pace with accelerating demand. The global logistics company had on average 33% more ecommerce shipments per day in Q1 2021 than in Q1 2020.

**Labor shortages increase tax complexity**

A worldwide shortage of labor is compounding supply chain woes and stifling economic growth.

About 40% of small businesses and 55% of midsize businesses surveyed between May 24 and June 4, 2021, were having a hard time finding qualified employees, and the situation didn’t improve as the summer progressed: Job vacancies in the U.S. in August 2021 were up 33% over Q4 2019.
As the U.S. grapples with a “wave of resignations,” strikes and COVID-19 infections are curtailing operations at ports in Australia. Britain has about 20% more job vacancies than before the pandemic, and one week in mid-July, the pingdemic forced 618,903 people in England and Wales to leave work and quarantine for 10 days due to exposure to COVID-19.

Businesses reliant on bodies, like restaurants and retail shops, are finding it particularly challenging to fill positions. And of course, labor issues are affecting the supply chain: Once products reach their country of destination, it takes longer for them to reach businesses and consumers due to the lack of port operators, truck drivers, and delivery service workers.

To retain existing employees and attract new hires, companies must raise wages; hourly wages in the U.S. rose by 0.6% in September 2021 alone. However, higher wages generally translate to higher prices. Though temporary price hikes caused by higher fuel costs typically drop once those costs come down, it’s difficult to cut wages once they’ve been raised.

Supply chain and labor woes can complicate sales and use tax compliance in several ways, including:

- **NEW PRODUCTS:** Are new SKUs exempt or taxable? If taxable, at what rate?
- **NEW SUPPLIERS:** Are all resale/exemption certificates valid and up to date?
- **MORE DROP SHIPPING:** Who’s liable for any tax due?
- **MORE REFUNDS:** Do sales and use tax returns need to be amended?
BUSINESSES CAN NO LONGER RELY ON TAX RELIEF

To help businesses and individuals survive mandatory COVID-19 restrictions, federal and state governments launched a host of COVID-19 tax relief measures shortly after California issued the nation’s first statewide stay-at-home order on March 19, 2020. By March 26, 2020, the Senate had passed the first of several federal coronavirus economic relief acts.

In the year that followed, there were more federal, state, and even local relief packages. Much of that relief has now ended.

MORE TIME TO FILE AND REMIT SALES TAX

Tax officials usually penalize businesses for not filing and remitting on time, but during 2020 and into 2021, numerous states and some localities gave businesses more time to file and/or pay tax.

Businesses struggling due to COVID-19 were encouraged to use unremitted tax revenue to cover essential expenses like wages or rent, if necessary. For the most part, filing and payment extensions have now expired, and businesses are liable for all tax revenue collected.

SHIFT TO REMOTE WORKFORCE IMPACTS TAX OBLIGATIONS

State (and some local) governments also lightened the tax burden by not enforcing certain nexus rules. Nexus is the connection between a state and a business that authorizes the state to tax the business.

One of the most common ways for a business to establish nexus is through physical presence in a state, such as employees, inventory, or offices. When companies imposed work-from-home mandates in response to the first wave of
the coronavirus, many suddenly found themselves with a physical presence – and therefore nexus – in states where their employees lived.

Pandemics aside, traveling across state lines for work is fairly common. Nearly one-fifth of employed New Hampshire residents traveled out of state for work in 2015, while about 13.5% of New Hampshire workers commuted from Maine, Massachusetts, or Vermont. Thousands of Kansans commute to jobs in Missouri, Oklahoma, Nebraska, and other states. Many people who work in the District of Columbia reside in Maryland or Virginia. In fact, only about 30% of D.C.’s workforce actually live in the District.

To help ease the tax burden on companies and their employees, many states chose not to enforce normal nexus rules when employees were forced to work remotely due to COVID-19. Some states have allowed those temporary policies to expire, while others have adapted their nexus rules to the tenacious virus.

For example, in 2020, Pennsylvania said it would not seek to impose sales and use tax nexus or corporate income tax nexus “solely on the basis” of employees working remotely in the state because of COVID-19. Yet as of July 1, 2021, out-of-state companies with employees working from home in Pennsylvania may have an obligation to collect and remit Pennsylvania sales tax and to validate exempt sales in Pennsylvania. These companies may also have corporate income tax and withholding tax obligations.

Likewise, Massachusetts resumed its pre-pandemic policy on September 16, 2021. During the early days of the pandemic, employees working from home in Massachusetts solely due to COVID-19 didn’t create sales and use tax nexus; they now once again do. Yet in some situations, Massachusetts now allows residents who worked in another state prior to the
pandemic to claim a credit for taxes paid to that other state. This is a departure from its pre-pandemic policy.

Indiana initially said it wouldn’t use employees working from home in the state due to COVID-19 as a basis for establishing nexus for out-of-state companies. However, that lenient policy expired June 30, 2021. Employees working from home in Indiana after that date could establish nexus for their employer.

Although certain industries rely heavily if not completely on in-person workers, some can make do with remote employees. Thus, LinkedIn and Meta (formerly Facebook) plan to allow employees to work remotely full time even after the risk of COVID-19 passes, while Google and Amazon are providing increased flexibility. States may well adapt their remote work tax policies as a new normal emerges.
The last dominoes fall: All states with sales tax now have economic nexus and marketplace facilitator laws

Though one of the predominant nexus triggers, physical presence is just one of several ways a business can create a sales and use tax obligation with a state. Companies with business dealings outside their home state need to understand the potential impact of economic nexus and marketplace facilitator laws.

You’d think tax compliance would be more straightforward now that there are economic nexus laws in every state. It isn’t.

**ECONOMIC NEXUS LAWS ARE DIFFERENT IN EVERY STATE**

On June 21, 2018, the Supreme Court of the United States determined physical presence isn’t required to establish sales and use tax nexus. The court’s landmark ruling in *South Dakota v. Wayfair, Inc.* granted states the authority to base nexus solely on a company’s economic activity in the state, or economic nexus. Physical presence in a state is no longer necessary, though it still triggers nexus.
Hawaii, Maine, and Vermont started enforcing economic nexus within days of the Wayfair decision, and by the end of 2020, most states and Washington, D.C., were doing the same. However, a few states had a hard time getting nexus laws on the books.

**Puerto Rico began enforcing economic nexus** on January 1, 2021. It can be challenging to find up-to-date information about tax requirements in Puerto Rico, especially for non-Spanish speakers. The research tools available through Avalara Tax Research can help.

**Florida enacted economic nexus** April 20, 2021, and began requiring certain out-of-state vendors to register starting July 1, 2021. That didn’t give businesses much time to prepare, but in fairness, businesses should have seen this coming. Florida had been trying to get an economic nexus bill to the governor’s desk since early 2019, if not before.

While waiting for the Kansas Legislature to adopt an economic nexus law, the Kansas Department of Revenue (DOR) decided any amount of sales into the state would establish nexus for a remote vendor given existing laws and the Wayfair ruling. While all other states provided
an exception for businesses whose sales in the state are beneath a certain economic nexus threshold (e.g., $100,000 in sales or 200 transactions in the current or previous calendar year), the Kansas DOR did not. Fortunately, for businesses, Kansas lawmakers eventually enacted an economic nexus law with a small seller exception. It took effect July 1, 2021.

Finally, Missouri, the last domino to fall. On June 30, 2021, the Show-Me State enacted a law requiring out-of-state sellers to collect and remit sales tax if they have at least $100,000 in cumulative gross receipts from the sale of tangible personal property in the state. But since Missouri has a stunningly complex sales and use tax system with more than 2,000 overlapping local taxing jurisdictions, economic nexus won’t be enforced in Missouri until January 1, 2023.

Between now and then, Missouri will likely consult with the Streamlined Sales Tax Governing Board, an organization that’s worked diligently for 30 years to simplify the burden and reduce the cost of sales and use tax compliance for businesses. According to Scott Peterson, vice president of government relations at Avalara and former executive director of the Streamlined Sales Tax Governing Board, “The Missouri Legislature didn’t adopt Streamline’s uniformity provisions but did direct the tax agency to utilize Streamline’s technology requirements. That should mean out-of-state sellers get to use certified service providers.”

A certified service provider (CSP) is an agent certified under the Streamlined Sales and Use Tax Agreement to perform all sales and use tax functions for a seller, aside from the seller’s obligation to remit tax on its own purchases. CSPs permit businesses to outsource most aspects of sales and use tax administration, which can significantly reduce the burden of compliance now impacting “nearly every seller in the country,” as Peterson notes, not merely businesses with physical presence in a state.
EVEN A STATE WITH NO SALES TAX MAY TAX REMOTE SALES

Like Delaware, Montana, New Hampshire, and Oregon, Alaska has no general, statewide sales tax. However, more than 100 local districts (cities or boroughs) in Alaska levy local sales taxes, and roughly 40 of these now enforce economic nexus.

ALASKA CITIES AND/OR BOROUGHS THAT ENFORCE ECONOMIC NEXUS

Source: Alaska Remote Sellers Sales Tax Commission

- Cities with general retail sales tax nexus
- Boroughs with general retail sales tax nexus
- Boroughs without general retail sales tax nexus

To make registration, remittance, and returns easier for remote sellers, the localities have created a single statewide economic nexus threshold and administrative system (Alaska Remote Sellers Sales Tax Commission, or ARSSTC). Sellers must register with the ARSSTC within 30 days of meeting the state economic nexus threshold. Once registered, they must validate exempt sales and maintain records related to sales and exemptions for at least three years.
ECONOMIC NEXUS CAN AFFECT BUSINESSES THAT ONLY MAKE EXEMPT SALES

It’s important to underscore this fact: An economic nexus law can affect even businesses dealing primarily or exclusively in exempt transactions in the state.

As noted earlier, all states with economic nexus now provide safe harbor for companies selling beneath the state’s economic nexus threshold. Some states base their threshold on taxable sales only, and some base it on retail sales, which include exempt sales but not sales for resale. However, most states base economic nexus on gross sales, meaning out-of-state companies must count exempt transactions into the state.

For example, these states base economic nexus on:

- **Alabama**: $250,000
  - Trigger and threshold: $250,000 in total retail sales of tangible personal property in the state in the previous calendar year.
  - Included transactions: Exempt sales; sales made through a non-collecting marketplace
  - NOT included transactions: Wholesales; sales made through a registered marketplace

- **Idaho**: $100,000
  - Trigger and threshold: $100,000 in cumulative gross receipts from taxable and exempt sales of products and services in the state in the current or preceding calendar year.
  - Included transactions: Sales made through a marketplace

- **Texas**: $500,000
  - Trigger and threshold: $500,000 in gross revenue from sales of tangible personal property and services into the state in the previous 12 months.
  - Included transactions: Exempt transactions; sales made through a marketplace

Source: Avalara

If your exempt transactions give you economic nexus with a state, you’ll need to register for sales and use tax, validate exempt sales with a valid exemption or resale certificate, and file returns.

As with all sales tax laws, economic nexus laws and thresholds are subject to change. And they do change,
particularly since many states rushed to enact and enforce them. Several states, most recently Maine, eliminated their transaction thresholds. Some increased or reduced sales thresholds or clarified which sales are included or excluded from the threshold.

Knowing how soon you need to register and start collecting sales tax after meeting a threshold is another critical component of compliance, and one subject to change. Kentucky recently gave remote vendors **an extra 30 days to register** after crossing the threshold, so they now have 60 days to get themselves squared away. In many states, including Ohio, **businesses must register immediately after meeting the threshold**.

The onus to register after establishing nexus always falls on businesses. Peterson points out that states don’t feel the need to notify sellers of their obligation to collect sales tax. “States assume every seller is engaged in business in their state and has been since the state enacted its economic nexus law.”

**EVEN LOCAL GOVERNMENTS ARE ADOPTING ECONOMIC NEXUS LAWS**

States aren’t the only government entities to embrace sales tax economic nexus. Increasingly, **local governments in certain states are looking to benefit from the South Dakota v. Wayfair, Inc. decision** too. This could seriously complicate and increase the cost of compliance for affected businesses.

Though sales tax is levied and administered at the state level in most states, local governments have the power to levy and administer local sales tax in a handful of **home rule states**, several of which are now exploring economic nexus.
A home rule city, Chicago “received numerous inquiries on
the topic of nexus” after Illinois began enforcing economic
nexus on October 1, 2018, but didn’t issue guidance until
January 21, 2021. At that point, it announced a safe harbor
threshold of $100,000 in revenue from Chicago customers,
effective July 1, 2021; businesses with no physical presence in
Chicago are liable for certain Chicago taxes (to be remitted
to the Chicago Department of Finance) if they meet or
exceed that threshold.

If more cities in home rule states take similar action, it could
pose a tremendous burden on businesses. The home rule
state of Colorado has more than 70 jurisdictions with broad
taxing authority, and some have adopted local economic
nexus provisions. The Colorado Department of Revenue
is working to streamline registration, collection, and
remittance of local sales taxes for remote sellers, but some
businesses may still be required to register with local tax
jurisdictions as well as with the state.

Local tax requirements can be incredibly hard to track. Breen
Schiller of Eversheds Sutherland says some uncommon
taxes (e.g., the personal property lease transaction tax) in
Chicago are unknown even to companies based in Chicago
– until they get audited. The more creative and aggressive
localities get, the more difficult it will be for companies to
remain in compliance.

According to Peterson, “Economic nexus is generally a state-
level requirement and local governments benefit from their
state imposing the requirement. It’s complicated in states
where local governments administer their own sales tax.
The authority granted by the Supreme Court in Wayfair was
clearly given to states and there is some debate whether
local governments can exercise the authority independently
from the state. Notwithstanding the debate, some local
governments have enacted ordinances that mirror the
states’ laws hoping remote sellers will start to collect.”
For businesses, local economic nexus requirements can greatly add to the burden of compliance. In addition to registering with and remitting to the state, companies may need to register with and remit to local tax authorities. The more places you sell, the more difficult it is to manage these compliance activities manually.

GOVERNMENTS WORLDWIDE ARE REGULATING AND TAXING CROSS-BORDER ECOMMERCE

In addition to complying with U.S. tax requirements, ecommerce companies selling internationally must comply with tax obligations in countries where customers are located. Tax authorities in many countries are considering the best way to tax online sales. For example, HM Treasury in the U.K. is currently exploring “arguments for and against a UK-wide Online Sales Tax.” Learn more about international ecommerce tax reform.

Marketplace facilitator laws are in flux

Economic nexus laws generally go hand in hand with marketplace facilitator laws that make marketplace facilitators (e.g., Alibaba, Amazon, eBay, Walmart, etc.) responsible for collecting and remitting sales tax on behalf of their third-party sellers in addition to collecting and remitting for their direct sales.
Because marketplace facilitators are required to collect and remit tax on all sales made through the platform, these laws enable states to capture tax revenue from remote marketplace vendors selling beneath the economic nexus threshold. It’s an enormous market.

In 2020, consumers worldwide spent $2.67 trillion on the top 100 online marketplaces, 50 of which are based in the United States. Furthermore, marketplace sales accounted for 62% of global web sales in 2020.

Marketplace facilitator laws have been enacted in all states with a sales tax, plus Puerto Rico, Washington, D.C., and a growing number of local governments in Alaska. As with economic nexus, the last to enforce their law will be Missouri, on January 1, 2023.

New tax policies affecting marketplace transactions have also been adopted in other parts of the world, so companies that conduct cross-border business should familiarize themselves with their international obligations.
THINGS TO WATCH OUT FOR WHEN SELLING THROUGH A MARKETPLACE

It’s important to note that marketplace facilitator laws don’t necessarily eliminate all sales tax requirements for marketplace sellers. In fact, these laws can complicate or add to them.

If you sell through a marketplace and make direct sales, you need to know whether to include or exclude your marketplace sales when calculating a state’s economic nexus threshold. They’re included in many states, like California, and excluded in others, like Colorado.

States generally require in-state marketplaces to register. Some require out-of-state marketplace sellers to register and file returns even if they only sell through a registered marketplace. In Connecticut, for example, remote marketplace sellers must register with the Department of Revenue Services, file annual returns, and deduct sales made through a registered marketplace if they meet transactions and sales thresholds, even if all sales are made through a marketplace that collects on their behalf. However, Florida doesn’t require remote marketplace sellers to register unless they make “a substantial number of remote sales to Florida customers outside of the marketplace.”

Source: Avalara
Third-party sellers also need to know where marketplaces store inventory and fulfill orders. Even if it’s only kept in the state briefly, inventory usually gives a business physical nexus in a state. That’s the case in California and Washington state, which have held marketplace sellers liable for sales tax based on inventory in third-party warehouses.

On the other hand, New York law specifies that inventory stored on the premises of an unaffiliated third party that performs fulfillment services does not, in and of itself, create nexus.

It’s key to understand how other sales tax laws affect marketplace transactions as well. For example, sales made through a marketplace don’t qualify for the occasional or isolated sales exemption in Illinois and Minnesota. However, the exemption for isolated or occasional sales may apply to marketplace transactions in Connecticut and New Mexico. And in Wisconsin, nonprofit organizations may be able to exclude sales made through a marketplace when determining if their sales in the state are regular or occasional.

“Most states didn’t think about their occasional or isolated sale exclusions when drafting their economic nexus law,” says Scott Peterson. “Many eBay sales would qualify as occasional or isolated if sold directly by the property’s owner, and sales tax would not be due.”

Knowing which types of businesses are subject to marketplace facilitator laws is also critical. Do they apply to online travel agencies? Third-party food and beverage delivery services? Though marketplace facilitators have been responsible for taxing third-party sales in Puerto Rico since January 2020, marketplaces facilitating sales of prepared foods have been eligible to collect the reduced rate of tax that applies to those sales only since May 2021.
And while marketplace transactions and drop shipments may seem the same to consumers, **third-party fulfillment and drop shipping aren’t quite the same**. California is working to clarify that marketplace sales are not drop shipments so all involved parties have a clear understanding of who’s responsible for sales tax.

Finally, marketplace facilitator laws are subject to change like all sales tax laws. California and Texas are among the states that have **expanded collection requirements for marketplaces facilitators** since their laws first took effect, requiring facilitators to collect additional taxes and fees on top of sales and use tax. Illinois is working to do something similar.

Georgia began **requiring marketplaces to collect and remit state and local lodging taxes** on July 1, 2021. On the same date, remote sellers and marketplace facilitators became liable for Indiana’s fireworks public safety fees, prepared wireless service charges, waste tire management fees, and a new electronic cigarette tax.

**Illinois had to correct its marketplace facilitator law** because the way it was originally written caused some transactions to be taxed twice. Under a law that took effect August 27, 2021, Illinois “refined the definition of marketplace facilitator to no longer include any person licensed under the Auction License Act.” However, as noted by the **Illinois Department of Revenue**, “internet auction listing services ... are still considered marketplace facilitators.”

The local tax conundrum may exist for marketplace facilitator laws too. According to **Nikki Dobay of Eversheds Sutherland**, West Virginia allows localities to impose marketplace collection requirements on online travel companies. Since there’s no centralized administration option for these companies, the cost of compliance is considerable: hundreds of thousands rather than thousands of dollars.
What every small and midsize business needs to know about nexus

The Wayfair ruling isn’t new, nor are the economic nexus and marketplace facilitator laws adopted by states in its wake. Yet evidence suggests many small and midsize businesses still may not fully understand economic nexus or its potential impact.

According to a survey conducted by CPA Trendlines in the first part of 2021, 39.37% of accountants surveyed believed their small businesses clients were “mostly not in full compliance” with collection and remittance requirements. Another 38.95% said only “some” of their small business clients were in compliance.

In early 2021, NetReflector/Potentiate asked small companies (<20 employees) and small and midsize businesses (20–499 employees) to quantify sales in states where they weren’t registered for sales tax. Approximately 80% of the small companies said they sold between $50,000 and $3 million annually in states where they weren’t registered, for a mean of $678,000. Since the economic nexus thresholds in most states are $100,000 and the maximum economic nexus threshold for a state is $500,000, some of those businesses probably have economic nexus and should be registered for sales tax in at least some states where they’re not. Nonetheless, respondents were generally confident they were complying with all applicable tax laws.

Peterson says the overall high volume of sales remote businesses have in states “explains why states assume
every remote seller had nexus on the date the state’s economic nexus law went into effect.” He’s heard states often make assessments based on their economic nexus effective date for sellers who register afterward.

The fact that nearly every state now taxes remote sales heightens the complexity and burden for sellers. Tracking sales tax nexus laws across all states is an enormous task, especially since they can change at any time. It’s particularly challenging for growing businesses that are exploring new sales channels or suppliers and entering new markets.

Potentiate found that small and midsize companies generally have two to five employees working on sales tax (at a mean hourly wage of $98), while their smaller counterparts can typically get by with three employees or fewer devoted to sales tax (at a mean hourly wage of $83). On top of that, small and midsize companies often need to bring on additional staff or external services providers to help manage sales and use tax compliance.

The point is, dealing with sales tax takes time, money, and resources. If you get it wrong, it takes more time, money, and resources to make it right.

Avalara’s cost of manual compliance calculator can give you an idea of how much you spend on sales tax compliance, as well as how much automating sales tax compliance can help you save.
The digitalization of tax compliance

To reduce the tax gap (or tax not remitted), countries worldwide are increasingly digitalizing tax compliance. According to the Organisation for Economic Co-operation and Development’s Tax Administration 2021 report, “More sophisticated data use means compliance work can focus on prevention.” Digitization efforts result in “the identification and prevention of new risks, the prevention of errors and the reduction of cost.”

Scott Peterson says the sales tax gap in the U.S. primarily stems from businesses not registered to collect and remit as they should. To narrow that gap, some states are mining data to enhance compliance and increase tax collections. Most states in the U.S. aren’t quite ready to fully digitalize tax compliance, but they’re watching what other countries are doing with interest and learning.

The digitalization of tax compliance is the movement by tax authorities of paper compliance activities to the cloud. Governments are increasingly digitizing interactions with enterprises, mandating electronic invoicing, digital filing and reporting, audit activity, and more.
What the numbers tell us:

More than 80% of tax administrations surveyed by the OECD report using data science and analytics tools.

Close to 75% of tax administrations surveyed by the OECD report using or implementing the use of cutting-edge techniques, including artificial intelligence and machine learning.

30–50% of tax administrations surveyed by the OECD are using artificial intelligence (including machine learning), digital identification technologies, and robotic process automation (RPA) – simple software commands that automate highly repetitive, rules-based processes like data entry, data validation, and data reconciliation.

More than 60 COUNTRIES have electronic invoicing requirements.

Source: Umpqua Bank

81% of small and midsize U.S. companies are digitizing new areas of their business to become more efficient.

OUTSIDE THE U.S.: ELECTRONIC INVOICING, REAL-TIME REPORTING, AND SAF-T

Electronic invoicing (e-invoicing), real-time reporting, and Standard Audit File for Tax (SAF-T) requirements are sweeping the globe.
E-invoicing entails submitting invoices electronically to customers. IDC MarketScape finds that “e-invoicing mandates are quickly taking root” as tax authorities around the world actively modernize their infrastructure to close the value-added tax (VAT) gap. According to Kid Misso, vice president of new initiatives at Avalara, “83 countries currently have some kind of e-invoicing or e-reporting legislation.” Countries with e-invoicing requirements include Argentina, Iceland, and India.

Real-time reporting takes the process further, requiring businesses to electronically report sales transactions via e-invoices as they occur, or shortly thereafter. There are many variations of real-time reporting, according to Ulf Schmidt, senior product manager of e-invoicing at Avalara. Hungary and South Korea have some of the most stringent requirements, as reporting needs to be more or less in real time. Greece and Spain allow businesses a bit more time to report. Italy is instituting new accelerated reporting requirements in 2022, and, for the first time, Saudi Arabia will implement e-invoicing beginning December 2021 through January 2023.
SAF-T is an electronic schema developed for the efficient exchange of information between businesses and tax authorities. France, Portugal, and Romania are among the countries with compulsory SAF-T requirements, and Poland is one of the most advanced countries in terms of SAF-T. In some countries, such as Austria and Norway, SAF-T is required on an on-demand basis only, typically before an audit.

In Brazil, Mexico, and a growing number of countries, businesses cannot complete a transaction until the tax authorities authorize it.

Mexico began digitizing tax compliance back in 2010 and introduced e-invoices in 2014. Tax authorities need to approve invoices before the recipient can claim input VAT, and tax returns, accounting records, and other tax disclosures must be filed in standard electronic format. Given the thoroughness of their system, Mexico and its Tax Administration Service (SAT) have become the new model for real-time compliance.

**TRENDS IN THE EFFECTIVENESS OF SAT REVENUE COLLECTION IN MEXICO**

<table>
<thead>
<tr>
<th>Revenue collected (billion MXN pesos)</th>
<th>Tax-to-GDP ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
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<td>2002</td>
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<td>2017</td>
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<td>2018</td>
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</tr>
</tbody>
</table>

Source: Better Than Cash Alliance
Britain has begun to move in that direction with its **Making Tax Digital** (MTD) program. This entails the digital submission of VAT returns, establishes certain digital record-keeping requirements, and mandates digital links, a way for Her Majesty’s Revenue & Customs (HMRC) to access digital records.

The global trend is moving toward more stringent requirements to further reduce tax gaps. Tax officials in Brazil have been mining tax data for years, cross-checking it to ensure nothing looks amiss. According to a [KPMG report from 2018](https://www.kpmg.com), “data mismatches now drive more than 90% of tax audits in Brazil.”

André Cordeiro, planning and management advisor at the Ministry of Finance of Bahia, **elaborates on the rewards of digitization:** “Before, audits used to be carried out by sampling: For example, out of every 100 companies, we selected five or six to verify their tax compliance. Now, we verify all 100, and in real time, with less staff and paperwork, and more efficiency and transparency.”

Misso expects the whole VAT and invoicing process to become digital in the coming years as the tax-tech landscape continues to evolve. Currently, **countries with electronic invoicing, real-time reporting, and/or SAF-T requirements** include, but aren’t limited to, Argentina, Brazil, Chile, Colombia, Greece, Hungary, India, Italy, Peru, Poland, Slovakia, Slovenia, Spain, and Turkey. [Learn more about the digitization of tax reporting](#) and tax compliance issues happening in the rest of the world.

**IN THE U.S.: PANDEMIC UNDERSCORES BENEFITS OF MAKING TAX DIGITAL**

The pandemic has spurred the need for federal, state, and local tax authorities in the U.S. to digitalize tax compliance.
In fact, the Federal Reserve and the Business Payments Coalition (BPC) are in the midst of a pilot project aiming to "modernize business-to-business payments" through the development of a standardized electronic invoicing system. According to a BPC press release, "73 organizations have joined an industry effort to stand up an operational pilot exchange framework to enable businesses of all kinds to exchange electronic invoices (e-invoices). Another 42 organizations will strive to assess whether a similar exchange framework can facilitate electronic delivery of remittance information across all payment types." The pilot program will run through the end of 2022; an operational B2B invoice exchange network could be ready by 2023.

States aren’t quite there yet. Many tax departments around the country are still heavily reliant on paper, and they suffered when COVID-19 forced them to shift to a remote work model. Scott Peterson and Liz Armbruester, senior vice president of global compliance operations at Avalara, sum it up nicely: “In what is becoming a digital-first society, reliance on paper-based processes is not only inefficient, but it also increases risk in the event of major disruptive events.”

Armbruester and Peterson believe integrating tax technology, as many other countries have done, would allow both businesses and governments to reduce complexity and increase compliance. States are certainly hungry for more data, according to a study by the Urban-Brookings Tax Policy Center. They know little about the businesses collecting sales tax on their behalf, and generally don’t know whether all remote sellers are registering, collecting, and remitting as they should.

“One of the real benefits of digitalization,” says Armbruester, “is data collection and optimization for analysis that can drive tax compliance forward. Digital transformation creates a system for gathering the right data and incorporating it fully for business intelligence at a higher level.”
WHEN TAX GOES DIGITAL, AUDITS GET EASIER FOR STATES

State tax authorities use the data they do have to uncover noncompliant businesses.

The New York State Department of Taxation and Finance mines data to help discover deviant patterns and identify the “next best case.” The California Department of Tax and Fee Administration (CDTFA) uses the information Amazon and other online marketplaces are required to provide to identify third-party sellers with inventory in the state. The CDTFA is clear: Maintaining inventory in California gives a seller physical nexus and a sales tax obligation.

Where’s there’s sales tax nexus, there’s often income tax nexus. According to Richard Cram, director of the National Nexus Program at the Multistate Tax Commission, “it would basically be standard practice for a state tax agency to look at taxpayers registering for sales tax but not income tax and inquire why those taxpayers did not register for both sales tax and income tax.”

A spokesperson for the California Franchise Tax Board confirmed that opinion, “We have been pursuing cases based on sales tax returns for years.” The pandemic is merely accelerating complexity and compliance efforts.

Digitalizing tax compliance would help states pinpoint the cause of their tax gaps and plug any holes that exist. Yet the more real-time reporting and digitized tax filing mandates are adopted, the more challenging tax compliance will be for businesses. Fighting fire with fire — or digitization mandates with tax automation solutions — may offer relief.
Other issues that could impact sales tax compliance in 2022

Flush with COVID-19 federal tax relief funds and stronger than anticipated tax collections, many states are likely to reevaluate their tax policies. Some, like North Carolina, could look to reduce or eliminate corporate income tax. Others, like Kansas, could try to lower the sales tax burden for certain businesses or individuals.

Despite surpluses, government and tax officials could turn their attention to the metaverse, where a growing number of companies are selling their virtual wares to an eager customer base. Which transactions in the metaverse are subject to tax? Who’s responsible for collecting and remitting it? These are some of the questions that will likely surface in 2022 and beyond.

As some businesses focus on opportunities opening up in intangible worlds, others will continue to grapple with new and changing tax requirements for remote sellers in the U.S. and abroad. For example, although still adjusting to fallout from Brexit and a 2021 ecommerce tax reform package, the U.K. is exploring the possibility of an online sales tax.

Discover more changes affecting cross-border sellers in the global tax changes section.
Global tax changes
Global ecommerce has exploded in recent years and shows no sign of abating. From approximately $1.672 trillion in 2015, global retail ecommerce sales are on track to reach $4.921 trillion in 2021 and could surpass $7 trillion by 2025. New markets and opportunities are opening to businesses at a rapid rate.

Yet the enormous volume of cross-border shipments is also straining a supply chain struggling due to factory closures, port backlogs, and labor shortages exacerbated by the ongoing COVID-19 pandemic. All of this adds to the burdens of international sellers already grappling with a raft of complicated cross-border compliance issues, particularly those related to indirect tax.

“Indirect taxation is one of the most complicated aspects of today’s business environment,” according to IDC MarketScape. In a report from October 2021, IDC stated “nearly every major economic region is undergoing some level of indirect tax reform and VAT/GST changes, which will add additional levels of frustration and complexity for businesses.”

There’s also a “massive shift toward digitalization” around the globe, both in products and services sold and in tax administration.

Other issues impacting international trade in 2022 include:

- ONGOING SUPPLY CHAIN DISRUPTIONS RESULTING FROM COVID-19
- A NEW EDITION OF THE WORLD CUSTOMS ORGANIZATION HARMONIZED COMMODITY DESCRIPTION AND CODING SYSTEM
- THE DIGITALIZATION OF TAX COMPLIANCE
- LINGERING EFFECTS OF BREXIT
- ECOMMERCE TAX REFORM
- THE NEW GLOBAL MINIMUM TAX DEAL
- THE UNITED STATES-MEXICO-CANADA AGREEMENT AND SECTION 301 IN NORTH AMERICA
Let’s get to it.

Global ecommerce is booming but the supply chain is stretched thin

For the most part, all commerce is global today, because whether you’re selling socks to your neighbor or shoes to Slovenia, something somewhere probably crossed an international border along the way. So the fact that COVID-19 made humongous waves in the oceans of global commerce matters. It’s going to take a while for the ripples to fade.

On top of the difficulties created by COVID-19, companies of all sizes from all parts of the world must navigate geopolitical boundaries and trade barriers. And, of course, no two countries are the same.

The good news: Consumer demand is high and commerce, particularly ecommerce, is booming. The not-so-good news: Inventory is low, supply chains are strained, there’s a labor shortage, and costs for just about everything are up.

What the numbers tell us:

After jumping 25.7% in 2020, worldwide retail ecommerce is expected to climb another 16.8% to $4.921 trillion in 2021, to $6.169 trillion by 2023, and to $7.385 trillion by 2025

Source: eMarketer
What the numbers tell us (continued):

32% of cross-border shoppers from 40 countries bought more from foreign online retailers in 2020 than in prior years; 51% expect to shop globally even more in the future.

Source: Digital Commerce 360

Shipping freight costs surged by 323% between September 2020 and September 2021 – and a whopping 570% on the most heavily trafficked routes.

From June 2021 to August 2021, average container prices at the Chinese port Yantian leapt from $5,515 to $15,336 after another Chinese port closed because of COVID-19.

Source: Global Trade Review (1) (2)

Nine in 10 companies surveyed are investing to improve supply chain resilience.

Source: Deloitte

The average cost of a 40-foot freight container rose from less than $2,000 in October 2019 to more than $10,300 in September 2021.

Source: Global Trade Review
It’s hard to fathom just how quickly freight costs rose in response to a **perfect storm of supply chain disruptions** that began in the early days of the pandemic, increased when the Ever Given wedged itself into the Suez Canal in March of 2021, and continues to this day. The disruptions include **closed and congested ports, increased demand, insufficient supplies** (raw materials and finished goods), **labor shortages, shuttered manufacturing facilities**, and **reduced airfreight space due to decline in commercial airlift**.

Transatlantic shipping rates dipped a bit in October 2021 but as of October 30, 2021, were still **385% higher than a year ago**, and more than seven times “above the pre-pandemic norm.” With all the world’s containers already in use, rates are unlikely to stabilize despite some shipping companies’ promises to cap one-time shipping fees (aka, spot rates) and **secure more long-term contracts**.

Of course, favorable long-term shipping contracts are generally the purview of large corporations. As so often happens when competition is fierce, the odds are stacked against small and midsize companies.

**Small and midsize companies hardest hit by supply chain issues**

Skyrocketing shipping costs and supply disruptions have put the squeeze on small and midsize companies. Small retailers reliant on the global shipping industry are **losing sales because they don’t have inventory to sell**. Prices for what inventory there is have increased. In fact, **costs for everything are up**, including packaging and wages.
Labor shortages are amplifying issues. During the summer of 2021, **50% of small business owners surveyed said they were having a harder time finding qualified employees** than last year, and the struggle to fill vacant positions continues. With fewer resources at their disposal, smaller businesses struggle to offer benefits and raise wages.

Certainly, large companies also find today’s strained circumstances challenging. Yet they have more resources to solve these problems. For example, Costco, Dollar Tree, Home Depot, IKEA, and Walmart all chartered container ships and leased or purchased containers to ensure they’d have merchandise to sell. This is something small businesses simply cannot do.

“With all the concerns over constricted global supply chains, the last thing most companies want to deal with is increasing compliance complexity for their cross-border shipments,” says Craig Reed, general manager of cross-border at Avalara. “Unfortunately, that’s exactly what’s happening.”

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**Source:** CNBC

**WE’RE HIRING**

**Percentage of small business owners who say they have open roles they have not been able to fill for at least three months**

- Q3 2021: 31%
- Q2 2021: 24%
- Q1 2020: 16%

Source: CNBC
The new Harmonized System is in effect as of January 2022

Another big challenge facing many companies is the release of the seventh edition of the Harmonized System by the World Customs Organization (WCO) on January 1, 2022. As with every edition since the first was created in 1988, the newest edition of the Harmonized System (HS 2022) will affect all participating countries — currently more than 200.

The Harmonized System is organized into 21 sections, 96 chapters, and 5,000 headings covering millions of internationally traded finished articles and components, each of which is identified with an HS code. These codes are used to identify and track every product that crosses an international border.

Every product. Let that sink in.
A cotton shirt has a different code than a silk shirt, and the code for a button-down differs from the code for a pullover. A ceramic mug with a handle has one code, a glass mug with a handle another. And so on, and so on, and so on.

Six digits is the global standard and the starting point for HS codes, but each country typically adds two to four (or more) digits to further define and distinguish products. The United States has used a 10-digit system from the outset. Mexico used eight digits until December 28, 2020, when 10 digits became the new standard.

<table>
<thead>
<tr>
<th>CHAPTER</th>
<th>HEADING</th>
<th>SUBHEAD</th>
<th>HTS</th>
<th>DESCRIPTION</th>
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</thead>
<tbody>
<tr>
<td>61</td>
<td>04</td>
<td>43</td>
<td>0010</td>
<td>Women’s or girls’ ensembles, jackets and blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts, knitted or crocheted; Dresses; Of synthetic fibers; Of polyesters containing spandex</td>
</tr>
<tr>
<td>61</td>
<td>03</td>
<td>43</td>
<td>0015</td>
<td>Men’s or boys’ suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts, knitted or crocheted; Trousers, bib and brace overalls, breeches or shorts; Of synthetic fibers; Shorts</td>
</tr>
<tr>
<td>61</td>
<td>11</td>
<td>20</td>
<td>0300</td>
<td>Babies’ garments and clothing accessories, knitted or crocheted: Of cotton; Sleepwear and underwear</td>
</tr>
</tbody>
</table>

So, the first six digits of the HS code for that ceramic mug with a handle would generally be the same no matter where it’s being shipped, but the remaining digits would differ if it’s going to Pakistan, Paraguay, or Portugal.

HS codes are tough to get right no matter what you sell or where you sell it. When they change, getting them right gets even harder. And many change January 1, 2022.
The WCO updates the Harmonized System every five years to account for new products and circumstances. There will be about 350 amendments in the 2022 edition, including specific provisions related to the classification of electrical and electronic waste (e-waste), as well as new provisions for novel tobacco and nicotine-based products. There will also be new provisions related to unmanned aerial vehicles (UAVs), more commonly known as drones, and a new subheading for smartphones. Many classifications for items with a low volume of trade will be deleted or substituted.

All 200+ member countries are supposed to adopt HS 2022 on January 1, 2022, but since it’s an enormous task and trade won’t stop if it doesn’t get done, complete adoption often ends up toward the bottom of the to-do list. In fact, it can take months or even years for a country to conform to the WCO’s most recent edition (i.e., adopt all changes). If the past offers any indication, about one-third of all WCO member countries won’t adopt HS 2022 by January 1, 2022 (Mexico used HS 2012 until implementing the 2017 version at the end of 2020).

Randy Rotchin, director of business development and global trade at Avalara, explains the impact delayed implementation can have on business: “For companies with extended global supply chains, the fact that not all
countries will implement HS 2022 on January 1, 2022, means many companies will have to use different HS codes for the same part or finished article depending on where it’s being shipped to.” That means they’ll have to devote even more time to this onerous task, and they’re more likely to get codes wrong.

Assigning the proper HS code to cross-border shipments is critical because HS codes are tied to import tariff (duty) rates. Misclassified products may be assigned a rate of duty that’s too low, which could cause delays, fines, or other problems at the border. Alternatively, a rate that’s too high could lead to disgruntled customers and fewer sales.

**HOW HS 2022 AFFECTS FREE TRADE AGREEMENTS AND RULES OF ORIGIN**

HS codes are also integral to determining whether a product is eligible for reduced tariffs or duty-free status under a bilateral or multilateral free trade agreement (FTA). This is complicated stuff, as most countries participate in at least one preferential trade agreement. There are about 350 regional trade agreements in effect today.

FTAs generally provide preferential treatment only to products originating in the country of export, not to products passing through or composed largely of imported components. To determine whether imported products qualify for preferential treatment, FTAs rely on rules of origin (ROOs). These, in turn, rely on HS product classification numbers to identify the national source of components and final products.

According to the International Trade Administration, “Rules of origin can be very detailed and specific, and vary from agreement to agreement and from product to product.” Rotchin offers additional insight: “Rules of origin can combine tariff shift, value, and processing requirements in

“For companies with extended global supply chains, the fact that not all countries will implement HS 2022 on January 1, 2022, means many companies will have to use different HS codes for the same part or finished article depending on where it’s being shipped to.”
different ways across different products. For example, NAFTA uses more than 80 different permutations of these criteria across the 5,000 HS subheadings.”

Goods subject to preferential treatment under one FTA may not qualify for preferential treatment under another FTA, and preferential treatment can be jeopardized if an HS code is wrong. That many HS codes change with the launch of HS 2022 on January 1, 2022, is a big deal, as is the fact that many countries won’t perform technical corrections to the tariff reduction schedules of their free trade agreements to align with the HS 2022 update.

According to Rotchin, “When an FTA is implemented under a previous HS version and no technical correction is performed, there will be discrepancies between the national tariff schedule and the tariff reduction schedule(s). In some cases, like Japan, importers will be required to classify and submit two classification numbers if they want to claim tariff preference – one according to the national tariff regime and one under the specific FTA.”
Another wrinkle: Supply chain issues are forcing many companies to develop new supply channels. With COVID-19 outbreaks closing factories in Southeast Asia, many companies are looking to move operations back to China, which they left during the Trump administration. Such changes can affect rules of origin and may threaten status with FTAs.

“Proper tariff classification is essential in establishing origin under a particular FTA,” says Rotchin. “Together, classification and origin determination are essential in identifying selling and sourcing opportunities abroad.” In other words, getting HS codes right is critical.

The digitalization of global tax compliance

2022 will also bring a greater push toward digitalizing tax compliance via electronic invoices, real-time reporting, and similar technology. Countries worldwide are digitalizing compliance to help reduce errors, eliminate tax evasion, and improve auditing. This represents an enormous change for businesses and governments alike.

Tax requirements can be governed by the location of your customers, not just your business. So, a company based in Oregon that sells wool jerseys to Bavarian cyclists must comply with Germany’s tax reporting regulations, as must a British manufacturer selling bicycle seats to stores in Hamburg and Munich.

If you want to grow your customer base beyond your borders, you need to understand and play by the rules in effect in the destination countries (i.e., where your customers get the goods). Tax authorities are honing tools to ensure growing companies comply with local tax requirements.
GLOBAL ADVANCES IN DIGITALIZING COMPLIANCE

A growing number of countries want – and are gaining access to – underlying sales data.

Over the past 10 years, there’s been a shift from self-reporting VAT returns to a system in which tax authorities insert themselves into the compliance process by asking for live (or near-live) transactional data.

There are several different ways countries go about this, listed below from least invasive/digitized to most, along with a country using that system:

To elaborate: Spain requires large businesses to make an Immediate Supply of Information within four working days of the issuance or receipt of an invoice. That’s something, but less than what’s required by tax authorities in Hungary who want to be given transaction/VAT data as each invoice is created. And in Brazil and Italy, tax authorities must validate an invoice before it can be passed to the customer.
To meet these and other compliance mandates, ERP or billing systems must be able to send data without any intervention from the reporter. This is virtually impossible to do manually, thus the need for tax automation.

Where are these requirements taking hold? An ever-growing number of places.

Latin America is “quickly becoming a leader in VAT transformation,” according to IDC MarketScape. “Countries like Mexico, Colombia, and Brazil have all taken major steps to embrace digital tax transformation in the past 18 months.” Indeed, Argentina, Brazil, Chile, and Mexico were among the first nations to institute e-invoicing requirements.

On the other side of the globe, South Korea is also a digitalization pioneer, introducing electronic invoices in 2011 and mandating e-invoicing for most taxpayers in 2014. Elsewhere, Singapore launched a voluntary e-invoicing scheme in 2019, and the Philippines began a pilot project in 2021 to expand an e-invoicing mandate based on South Korea’s model. India has been gradually digitalizing compliance for business-to-business (B2B) transactions, while Vietnam delayed its electronic invoice mandate to July 1, 2022, because of the pandemic.

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**In the coming years, more countries will institute more digitalization requirements.**

**For example:**

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<thead>
<tr>
<th>2022 WILL SEE</th>
<th>2023 WILL BRING</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ E-invoicing in Vietnam</td>
<td>✓ E-invoicing to Poland</td>
</tr>
<tr>
<td>✓ SAF-T to replace VAT returns in Norway</td>
<td>✓ Electronic cash registers to Czechia</td>
</tr>
<tr>
<td>✓ SDI requirements for cross-border transactions into Italy</td>
<td>✓ Qualified invoice regime to Japan</td>
</tr>
</tbody>
</table>
EVEN BRITAIN IS MAKING TAX DIGITAL

In the U.K., Her Majesty’s Revenue and Customs (HMRC) has been working to streamline value-added tax (VAT) compliance, minimize the VAT gap, and make tax digital since 2015. The next phase of the Making Tax Digital (MTD) program will go into effect April 1, 2022.

The MTD program strives to remove opportunities for “certain types of mistakes in preparing and submitting tax returns,” thereby reducing the tax gap. During the first phase of MTD, which launched in April 2019, the U.K. required VAT-registered businesses with taxable turnover above a certain VAT threshold (currently £85,000) to file returns with HMRC online, via a new API interface. This applies to non-U.K. businesses registered for U.K. VAT as well as U.K. businesses.

Effective April 1, 2021, the second phase of MTD added new digital record-keeping requirements and the tracking of digital journeys for those businesses, plus penalties for infringement and late filings.

In the next phase, beginning April 1, 2022, VAT-registered businesses (including the self-employed and landlords) not already required to operate MTD must comply with digital record-keeping requirements and provide VAT return information to HMRC through MTD-compatible software. HMRC anticipates these requirements will affect approximately 1.1 million VAT-registered businesses with taxable turnover below the £85,000 VAT threshold.

Companies selling into the U.K. and other countries that are digitalizing compliance must be able to pull necessary data in a specific format, ensure it’s technically correct, then submit it to the tax authorities as required. Read more about e-invoicing, real-time reporting, and similar mandates.
Lingering effects of Brexit

On top of the compliance digitalization changes, which are considerable, companies with business dealings in the U.K. are still dealing with the fallout from Brexit. According to Alex Baulf, senior director of government and influencer relations at Avalara, “Despite the pandemic-fueled boom in online shopping driving huge growth, a tidal wave of legislation post-Brexit has left many businesses feeling overwhelmed by the practicalities of selling online and internationally.”

BREXIT AND THE GREAT SAUSAGE ROW

Though the U.K. left the European Union Customs Union and VAT regime on January 1, 2021, there’s still unfinished business. One of the most contentious issues involves the Northern Ireland Protocol. The EU and U.K. are still struggling to resolve ongoing disagreements.

Under the terms of the protocol, Northern Ireland agreed to follow EU rules on product standards, so goods moving from Northern Ireland to the EU don’t need to be checked at the border. The EU has strict requirements for certain goods, such as milk and eggs, and it prohibits others (e.g., chilled meats) from entry.

The U.K. also agreed to align with “around 300 pieces of EU legislation” related to agriculture, customs, and product standards to allow goods to flow into Northern Ireland from Great Britain. But this would require the U.K. to prove compliance with EU law through “new checks and paperwork” – including customs declarations and physical inspections on most agrifoods.
Although the Protocol on Ireland/Northern Ireland was signed by both parties, from the outset there’s been no consensus on how it should be implemented. The EU wants EU law to be fully applied; the U.K. wants the EU to be more flexible to minimize trade barriers between Great Britain and Northern Ireland. To allow the parties time to work through these and other issues, a grace period was established then extended. It ended October 1, 2021: Unless the EU and U.K. can come to another agreement, new customs reporting obligations will be imposed on many goods flowing from the U.K. into Northern Ireland.

Britain’s Brexit minister David Frost has said the U.K. would continue to operate the Protocol on the current basis, honoring the grace periods and easements in force “to provide space for potential further discussions, and to give certainty and stability to businesses.” Though on October 4, 2021, Frost reportedly said the U.K. will react in a “robust” manner if the EU launches a retaliatory trade war in the event of Brexit talks on Northern Ireland breaking down. And Jeffrey Donaldson, leader of the Northern Ireland Democratic Unionist Party (DUP) said they would “block any additional steps taken at ports to police the Brexit trade restrictions.”

For its part, the EU maintains “both sides are legally bound to fulfil their obligations under the Agreement.”

It’s a mess, and as of this writing, there’s no clear path to resolution. Despite Frost’s desire to “give certainty and stability to businesses,” businesses selling into Northern Ireland from Great Britain are facing a great deal of uncertainty.

Alex Baulf says the European Commission wants to protect the EU single market while at the same time giving Northern Ireland a special status within the EU. He explains, “The Protocol arrangement has led to several layers of added complexity – what was previously a purely domestic
delivery with just logistical and commercial considerations is now complicated by complex customs formalities to differing degrees, and confusion and conflicting guidance. It is now arguably more difficult for British businesses to ship to Northern Ireland than the rest of the world.”

Ecommerce tax reform

Internet sellers with customers in numerous countries are also sorting through the U.K. ecommerce package – which is unrelated to Brexit – as well as new One-Stop Shop (OSS) streamlined registration in the EU.

Additionally, online marketplace platforms (OMPs) and businesses that sell through them are coming to grips with the fact that marketplaces are now the deemed supplier liable for tax in the EU and the U.K.

ECOMMERCE IMPORTS INTO THE U.K.

The ecommerce package implemented by the U.K., at the start of 2021 seems to be chugging along as planned. As of January 1, 2021:

- All imports into the U.K. are subject to VAT eliminating the Low-Value Consignment Stock relief for goods valued beneath £15

- All imports valued at or below £135 are subject to sales (supply VAT); sellers must collect VAT at checkout and remit it to HMRC

- Online marketplaces are the deemed supplier responsible for charging and reporting the VAT due on imports valued at or below £135

There’s no change in process for imports valued above £135: Sellers with a U.K. VAT number can pay import VAT and duties upon clearance at customs rather than collect it from...
customers at checkout, or require the customer to pay VAT to customs or the delivery agent.

![Diagram: U.K. Ecommerce Package Changes as of January 1, 2021]

Source: Avalara Tax Desk

Given the high volume of global ecommerce transactions today, Craig Reed thinks sellers interested in growing into lucrative markets like the U.K. are now “saddled with increased complexity and regulatory requirements at the border.” He adds, “Solving for these challenges is key to being successful, but many companies aren’t equipped to solve it on their own.”

Adding to the complexity is the fact that tax requirements for businesses are subject to change. In fact, HM Treasury is currently examining the pros and cons of a U.K.-wide online sales tax. HM Treasury’s Autumn Budget and Spending Review from October 2021 states that revenue from an online sales tax “would be used to reduce business rates for retailers with properties in England.” If eventually adopted, the proposed tax would help level the playing field for brick-and-mortar and online sellers.
ONE-STOP SHOPPING IN THE EU

Meanwhile, cross-border businesses are still familiarizing themselves with the sweeping VAT reform package that came into force in the EU on July 1, 2021. These reforms affect EU and non-EU businesses in different ways.

The **One-Stop Shop** (OSS) is an electronic registration and portal that businesses can use to simplify VAT reporting on ecommerce sales within the EU. Its counterpart for low-value goods imported into the EU is the **Import One-Stop Shop** (IOSS), a new registration and electronic portal designed to simplify VAT compliance for the ecommerce merchants and marketplace facilitators that opt to use it.

Source: [Publications Office of the European Union](https://www.euractiv.com/)

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**ONE-STOP SHOP EXAMPLE**

The owner of an online business based in Austria

The business sells CDs and vinyl discs that are dispatched from Austria to customers in Germany and Czechia

The business also sells tickets to music concerts that take place in France and Germany

**OLD: MULTIPLE FILING**

Required to register for VAT and complete multiple VAT filings in each member state where the owner was selling

**NEW: ONE FILING**

Thanks to OSS, the business only needs to register in one member state (Austria) for cross-border transactions
For commercial shipments with a total shipment value under €150, sellers using IOSS must collect VAT at the point of sale (i.e., at checkout), not upon import into the EU. This allows them to benefit from a fast track, “green channel” for quick and easy customs clearance. Read more about how non-EU sellers can benefit from IOSS.

The impact on business is enormous, particularly for British companies feeling the effects of Brexit. Avalara estimates 26,000 ecommerce sellers (slightly more than 10% of the U.K. sector) will likely register for VAT for the first time under the EU’s new IOSS system due to the removal of the low-value goods import VAT exemption. This is a seismic change for a huge number of British businesses that now need to get this right ahead of future filings.

“The adjustment is not going to be easy, and it certainly won’t be cheap,” says Alex Baulf. “To prepare for the changes, U.K. ecommerce sellers are facing £180m in additional red tape costs to navigate these new tax reforms. That’s a tough bill to swallow – particularly in the current volatile economic climate.”

Yet he adds, “If sellers can get the right solutions and support in place now, there’s real potential to open up cross-border trading and empower British businesses to become major exporters. Though the upfront investment will hurt, if sellers can successfully embrace the benefits presented by IOSS, the U.K. is in a strong position to lead the world in ecommerce – unhindered by its third country status.”

**CAN CROSS-BORDER TAX REFORMS PLUG THE TAX GAP?**

The EU and U.K. implemented these and other changes to deal with the massive influx of ecommerce imports and to plug the VAT gap: Too many imports were being undervalued to avoid the duty and tax. The **EU lost**
approximately €140 billion in VAT revenues to fraud in 2018, and expects the 2020 VAT gap to reach €164 billion. According to EU Commissioner for Economy Paolo Gentiloni, these figures “show that efforts to shut down opportunities for VAT fraud and evasion have been making gradual progress – but also that much more work is needed.”

Other countries are taking similar steps to increase tax collections on cross-border transactions. For example, on July 1, 2021, Canada imposed new duty and tax requirements on nonresident vendors supplying digital products and services to consumers in Canada. The IDC MarketScape finds that, overall, “tax authorities around the world are becoming more aggressive – actively modernizing their infrastructure to close the VAT gap. Nearly every region is going through a level of indirect tax reform – including Canada, Malaysia, China, India and LATAM.”

Craig Reed elaborates: “As cross-border ecommerce has grown globally, governments have taken notice. Systems that were built to manage traditional trade patterns were turned on their head by the influx of ecommerce goods. As governments scramble to adjust to the changing trade patterns, their first concern will be making sure they collect...”
the duty and tax they are due. The secondary concern is the significant compliance burden this places on companies shipping into those jurisdictions. To make matters worse, each country will choose its own method to implement these rules making global compliance ever more difficult.”

**MARKETPLACE FACILITATORS ARE NOW THE DEEMED SELLER**

As noted earlier, as of January 1, 2021, Britain made online marketplaces the deemed supplier responsible for charging and reporting the VAT due on imports valued at or below £135.

*Similar requirements took effect in the EU July 1, 2021:* Online marketplace platforms (OMPs) that control the terms and conditions of the sale, authorize the charge to the customer, and order or deliver the goods are liable for VAT on all transactions made through the platform. Such marketplaces must collect, report, and remit the VAT due on two types of cross-border transactions:

**Source:** Avalara Tax Desk
Once a marketplace is named the deemed supplier, each sale becomes two separate transactions for VAT:

<table>
<thead>
<tr>
<th>TRANSACTION 1</th>
<th>TRANSACTION 2</th>
</tr>
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<tbody>
<tr>
<td><strong>EXEMPT B2B SALE</strong></td>
<td><strong>TAXABLE B2C SALE</strong></td>
</tr>
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</table>

- **EXEMPT B2B SALE**
  - The marketplace seller makes an exempt B2B sale of goods to the OMP (no EU VAT is due).

- **TAXABLE B2C SALE**
  - The OMP makes a taxable B2C sale to the final consumer and must collect the VAT due in the customer’s country of residence.

While this facilitates compliance for individual sellers, it makes it considerably more complex for OMPs. In addition to collection, remittance, and reporting requirements, OMPs must keep detailed records of all transactions to prove VAT was correctly accounted for. These records must be kept, in electronic form, for 10 years.

These are important changes that have a real impact on most international sellers. Yet for the biggest players, they’ve got nothing on the new global minimum tax deal.
The new global minimum tax deal

This is big.

In October 2021, 136 countries representing more than 90% of global GDP agreed to a global minimum tax plan proposed by the Organisation for Economic Co-operation and Development (OECD). This will subject approximately 100 of the world’s largest and most profitable multinational enterprises to a minimum tax of 15% beginning in 2023, and redistribute more than $125 billion in profits to countries around the globe.

The OECD has come up with a two-pillar solution to address the tax challenges arising from the digitalization of the economy:

![Image](https://example.com/image.png)

**PILLAR 1
REALLOCATE TO JURISDICTIONS**

Ensures a fairer distribution of profits and taxing rights among countries with respect to the largest and most profitable multinational enterprises (e.g., Meta/Facebook, Google). This should reallocate more than $125 billion to jurisdictions where such companies have business activities and earn profits, regardless of whether they have a physical presence in those jurisdictions.

**PILLAR 2
GLOBAL MINIMUM CORPORATE TAX RATE**

Introduces a global minimum corporate tax rate at 15% on companies with more than €750 million in revenue, starting in 2023. (Governments could impose a corporate tax rate higher than 15%, but not lower.) This should generate roughly $150 billion in additional global tax revenues annually.

Source: OECD
The OECD plan also requires the repeal of national digital services taxes, which have become increasingly popular throughout the EU in recent years. Roughly half of all European OECD countries have either already implemented a digital services tax or have them in the making, including Austria, France, Italy, and Spain. Even Canada and Mexico have joined the digital services tax party.

If the global minimum tax plan succeeds, it should reduce competition among governments. Currently, many countries reduce taxes on foreign companies so they’ll set up shop on their shores.
USMCA and Section 301

On July 1, 2020, Canada, Mexico, and the United States entered a new trade agreement, the United States-Mexico-Canada Agreement (USMCA). What does it mean for goods subject to punitive tariffs under Section 301?

USMCA

There’s a lot to unpack in USMCA, and we can only take a superficial look here. Worth noting, USMCA:

- Includes key provisions supporting small and midsize businesses
- Increases de minimis thresholds
- Cuts red tape at the border for shipments valued up to $2,500
- Requires online publication of laws, regulations, tariffs, taxes, and fees
- Prohibits customs duties on digital products distributed electronically

Source: Office of the United States Trade Representative, Avalara Tax Desk

Overall, USMCA provides preferential duty treatment for goods that qualify as USMCA originating and exempts certain shipments from merchandise processing fees.

SECTION 301

Section 301 of the Trade Act of 1974 is an enforcement tool that allows the Office of the United States Trade

[Insert Diagram or Table Here]
Representative (USTR) “to address a wide variety of unfair acts, policies, and practices of U.S. trading partners.” The Trump Administration used Section 301 to impose punitive tariffs of up to 25% on imports from China, which remain in effect today.

As the U.S. Government Accountability Office (GAO) notes, “U.S. firms affected by the tariffs could ask to be excluded from them. The Office of the U.S. Trade Representative received requests for over 53,000 exclusions.” Most were denied.

Harmonized Tariff Schedule of the United States (HTSUS) codes are used to identify products subject to the tariffs under Section 301, just as they’re used to determine customs duty and import tariffs for all cross-border shipments. The USTR provides a search engine to help businesses obtain information about proposed or ongoing Section 301 tariffs; to use it, you must have the HTSUS codes in hand.

HOW SECTION 301 AFFECTS USMCA

Are tariffs on goods that originate in China but pass through Mexico or Canada on their way to the U.S. governed by Section 301 or USMCA?

It depends.

Contributing factors include the classification of the products (i.e., HTSUS codes) and what happens to them once they land in Canada or Mexico. If they merely pass through, without being changed in any way, applicable Section 301 tariffs are likely still in force. However, if they’re significantly altered in Canada or Mexico, they may be eligible for preferential treatment under USMCA.

When in doubt, it may be best to consult with the USTR. One company sought guidance on goods it shipped from China to a logistics center in Mexico and then

Source: GAO

TARIFFS FROM CHINA
According to the U.S. Government Accountability Office, “In response to unfair trade practices, the U.S. imposed tariffs of up to 25% on imports from China. From July 2018-Dec. 2020 these imports amounted to $460 billion.”
Source: GAO

“If [products are] significantly altered in Canada or Mexico, they may be eligible for preferential treatment under USMCA.”

Guidance on goods it shipped from China to a logistics center in Mexico and then
on to the U.S.; it was told that “because no processing occurs in Mexico other than sorting, picking, packing, and shipping services, the goods remain products of China. The additional duties under Section 301 are applicable on all the goods at issue, except those classified under subheading 8517.62.00, HTSUS, which is not currently listed in U.S. Note 20 of Subchapter III, Chapter 99, HTSUS.”

Of course, every situation is different, and over time, trade agreements and tariffs can change. These factors contribute to the complexity of cross-border trade and compliance.

Other issues that could impact global tax compliance in 2022

All this just scratches the surface of global commerce which, by definition, is vast. There’s a lot more. For example:

There will likely be more focus on Latin American countries (LATAM), which are becoming a “leader in VAT transformation” according to the 2021 IDC MarketScape.

Countries will likely continue to grapple with the best way to respond to (and tax) the gig economy, which has transformed industries such as food delivery (e.g., DoorDash and Grubhub) and transportation (e.g., Lyft and Uber).

More cross-border sellers could respond to consumer (and stockholder) demand for carbon-neutral delivery. Danish container-shipping company Maersk has already ordered eight ships that will be powered by carbon-neutral green methanol, though it’s also interested in exploring additional alternative fuels. The ships will likely be 10% to

Source: Marketplace
15% more costly to operate than traditionally fueled ships, and those price increases will undoubtedly trickle down to retailers and consumers.

Supply chain troubles will probably persist, which could cause cross-border sellers to develop new supply lines closer to their markets. Those that do must keep FTAs and ROOs in mind. According to Matt Earish, senior director of customs at Avalara, “The need to implement dynamic supply chains to meet customer needs is becoming a priority for companies of all sizes. With large cross-border importers such as Walmart and Costco chartering their own vessels to markets in North America, small to midsize businesses will have to be creative to continue to meet customer demand.”

With more consumers buying from online shops based in other countries in 2020 than in previous years, and more expected to do so in the future, countries may work to ensure customs duty and import tax are collected as required on all imports. Businesses should expect more movement in this area in 2022 and beyond, as well as stricter enforcement efforts.

Visit the VATlive blog to keep your finger on the pulse of ongoing global tax changes, which Avalara can help you navigate.

Explore tax changes affecting the beverage alcohol, communications, hospitality, tobacco, and energy sectors in 2022, in the industry tax changes section.

“With large cross-border importers such as Walmart and Costco chartering their own vessels to markets in North America, small to midsize businesses will have to be creative to continue to meet customer demand.”
Industry tax changes
Retail

Retail has remained surprisingly robust throughout the pandemic, though what we’re buying, where we’re buying it, and how we’re paying for it have changed with the circumstances.

*What the numbers tell us:*

**Total U.S. retail sales are expected to rise 7.9% in 2021**

**Ecommerce could account for 15.3% of total retail sales**

**U.S. retail ecommerce sales will likely climb 17.9% to $933.3 billion**

*Source: eMarketer*
What the numbers tell us (continued):

In 2021, the global ecommerce market is expected to reach **$4.89 TRILLION**

Source: eMarketer

About 55% of U.S. marketplace sales made in 2020 occurred through mobile devices

Source: Digital Commerce 360

By 2023, worldwide retail ecommerce sales are projected to total $6.169 trillion and make up 22.3% of total retail sales, up from $3.351 trillion and 13.8% in 2019

Source: eMarketer

45.1 million people (aged 14 and older) are expected to have used a Buy Now, Pay Later (BNPL) platform in 2021, a year-over-year increase of 81.2%

Source: Marketplace Pulse

Ecommerce is evolving beyond Amazon and marketplaces; Shopify grew to be 40% as large as the Amazon marketplace and it’s just one of many companies facilitating direct-to-consumer sales

Source: Marketplace Pulse
There can no longer be just one way: Multichannel selling is essential (and complex)

The pandemic underscored the risks of relying on just one sales avenue when it prompted restrictions on in-person shopping, dining, and even travel outside the home or neighborhood.

Though shops and restaurants have, for the most part, fully reopened, the threat of mandatory closures or limitations lingers. Some parts of Australia were still under lockdown in October 2021, when outbreaks of the Delta variant and an exodus of employees were shuttering factories in Vietnam. Singapore was restricting activities in mid-November, shortly before detection of the Omicron variant raised fresh concerns.

We’re not done with this thing yet.

Even without government-mandated restrictions, some people still aren’t comfortable in public spaces, while others are delighted to be back in brick-and-mortar stores. Some folks like to shop online on desktops, laptops, or tablets; those with sharp eyesight may enjoy perusing mobile sites. There are consumers who go directly to their favorite retailers’ websites, those who comparison shop on marketplaces, and people who are inspired by what they see on social media and shoppertainment sites.

In short, different sales channels appeal to different people. They can also have different implications for sales and use tax compliance.
IN STORE

When it comes to the business licenses and permits needed to operate a brick-and-mortar store or other face-to-face sales operation (e.g., booth or kiosk), requirements differ from state to state. In general, both state and local licenses are required, and depending on what types of products or services you sell, you may need additional licenses and permits. It’s also important to track if and when licenses and permits expire, so you’ll know when to start the process of renewing them.

Special rules may apply in some states for certain types of sales operations. For example, although a kiosk isn’t considered a place of business in Texas, if you operate a kiosk in Texas, you’re required to register for sales tax.

Tax rates for kiosk sales in Texas are based on where orders are fulfilled: Kiosk sales shipped or delivered from a seller’s place of business in Texas are taxed at the rate in effect at the place of business – though if the local rate at that location is less than 2%, you may also need to charge the local use tax rate in effect at the delivery address. For kiosk orders fulfilled and shipped from outside the state, the tax rate is based solely on the delivery address.

ONLINE (DIRECT AND THROUGH MARKETPLACES)

Selling online to consumers in other states exposes your business to the economic nexus laws discussed earlier, as well as marketplace facilitator laws if you sell through marketplaces. It can also put you at risk of establishing other types of nexus.

Several states still enforce affiliate nexus laws that predate their economic nexus laws. Affiliate nexus is established through a connection between an out-of-state business
and its affiliated entities in a state. It can result from use of in-state independent contractors or non-employee representatives to create or maintain a market in the state, or when an in-state business uses a similar name to promote or maintain sales for the out-of-state retailer.

Some states also still enforce **click-through nexus** laws, which base a sales tax collection obligation on referrals made through links on a website owned or operated by an individual or business in the state.

A number of states repealed their affiliate nexus and click-through nexus laws after the Supreme Court validated economic nexus with the Wayfair decision, but many didn’t. And interestingly, Illinois repealed click-through nexus as of June 28, 2019, then reinstated it effective January 1, 2020.

Cookie nexus laws may also need to be considered. Before the Wayfair decision, a handful of states creatively based nexus on the cookies internet sellers place on computers to track and promote sales in the state. **Iowa** and **Rhode Island** still have cookie laws on the books, though there seems to be no mention of cookie nexus on the **Iowa Department of Revenue** or **Rhode Island Division of Taxation** websites. Both **Ohio** and **Massachusetts** repealed their cookie laws, but the old laws could still create past tax liability for businesses.

Scott Peterson explains, “Though now repealed, those cookie laws were in effect and enforced before they were repealed. Sellers who used cookies and could have been
subject to these laws when in effect should be careful if they are audited." And indeed, the Massachusetts Department of Revenue has issued assessments based on its cookie nexus provision for periods predating Wayfair. However, the Massachusetts Appellate Tax Board abated one such assessment in December 2021, finding that the cookies, etc., the company used to promote sales in Massachusetts did not establish a physical presence nexus.

And of course, marketplace facilitator laws can complicate compliance in a variety of ways. Inventory used to fill marketplace orders can give a third-party seller physical nexus in a state, often unbeknownst to the seller. Selling through marketplaces can make it more difficult to determine whether you’ve met a state’s economic nexus threshold. It can also alert a state to your presence and make auditors wonder if you’re registered and collecting sales tax as you should.

**BUY ONLINE, PICK UP IN STORE (BOPIS)**

Selling online and letting customers pick up their purchases in store has been a lifeline for many businesses during the pandemic, though it existed during the beforetimes as well. Businesses offering this option need to understand how it can impact sales tax compliance and ensure sales systems are set up properly.

Ecommerce systems are often set up to calculate tax based on customers’ shipping and/or billing address. Yet if a customer collects the goods at the store, tax should be based on the rate in effect at that store.

The rates could be the same, of course: Some states (e.g., Maryland) don’t levy local sales tax, and in states that do, a customer could reside in the same sales tax jurisdiction as the store.
But it’s also possible for a customer and retailer to be in different jurisdictions. Missouri and Colorado are two states where buildings located across the street from one another can have different rates due to overlapping sales and use tax jurisdictions. And in the city of Bristol, one side of the street is in Tennessee while the other is in Virginia.

No matter the location of the customer or the store, collecting the proper sales tax rate is a critical aspect of sales and use tax compliance.

**BUY NOW, PAY LATER (BNPL)**

One interesting side effect of the pandemic is the emergence of more buy now, pay later (BNPL) options (also called point-of-sale loans). In 2021, 45.1 million people in the U.S. – about 21.5% of digital buyers – are expected to use BNPL services, an 81.2% increase over 2020. In fact, most major retailers now offer BNPL plans.

It feels a bit old school: Any fan of Popeye will remember Wimpy and his catchphrase, “I’ll gladly pay you Tuesday for a hamburger today.” Yet younger consumers with less disposable income are more likely to use BNPL services than their older counterparts. Gen Zers comprised 30.3% of BNPL users in the U.S. in 2021, and Millennials a whopping 42.7%. With 84% of survey respondents in Sweden using BNPL services, consumers in other countries may be even more enthusiastic about these plans than Americans.
Consumers should pay close attention to the true costs of BNPL plans (some collect $0.30 from every payment made). And as with BOPIS, merchants must understand how BNPL plans affect sales tax. For example:

- **SHOULD TAX APPLY TO THE FULL AMOUNT WITH THE FIRST INSTALLMENT OR TO EACH PAYMENT SEPARATELY?**
- **IF THE SALES TAX RATE CHANGES BEFORE FINAL PAYMENT IS MADE, SHOULD THE NEW RATE BE APPLIED TO ANY REMAINING OPTIONS?**
- **ARE ANY FEES ASSOCIATED WITH BNPL SERVICES SUBJECT TO SALES TAX?**

The answers likely vary by state. In **Washington**, retail sales tax and business and occupation (B&O) tax for merchandise sold on installment is due in the reporting period when the sale is made, although full payment won’t be received until later. Separate charges for insurance, interest, and finance charges may be excluded from the sales price for B&O and sales tax, though such charges are subject to other taxes in Washington.

Somewhat related, Missouri recently clarified how layaway orders affect the exemption provided during a sales tax holiday. To qualify for the exemption, final payment on a layaway order must be made, and the buyer must take ownership of the property during a sales tax holiday. Alternatively, the seller must accept an order during a sales tax holiday for immediate delivery upon full payment (even if delivery is made after the exemption period). Additional details are in **Senate Bill 153**.
SALES TAX APPLIES NO MATTER HOW THE SALE OCCURS

No matter how you reach customers or manage their payments, if you have nexus in a state, you need to know which sales are subject to sales tax (and at what rate), which are exempt, filing and remittance requirements, and so forth. This can be challenging because sales tax rates, rules, and regulations are subject to change.

SALES TAX RATES CHANGE

Changes to sales and use tax rates and rules are a fact of life. Local rates change frequently in some states – Missouri is regularly featured in our sales tax rate change blog posts – while rate changes are less of a concern if you only make sales in Michigan and New Jersey. State sales tax rates change occur far less frequently than changes to local rates.

It’s also common for the boundaries of taxing jurisdictions to change, and this can affect rates. Boundary changes often stem from growth or contraction, as illustrated by these taxing jurisdiction boundary changes in North Dakota. In rare instances, they may also result from gerrymandering.

SALES TAX RULES CHANGE

In addition to state or local district rate changes, government and tax officials sometimes change the taxability rules for certain products. They may go from taxable to exempt, like diapers and feminine hygiene products in Louisiana as of July 1, 2022. Or a product may become taxable, like plastic carryout bags in Washington state starting October 1, 2021.

Georgia is providing a temporary sales tax exemption for sales of fees, tickets, or charges for admission to certain exhibitions or fine arts performances. Not all fine arts exhibitions or performances qualify for the exemption, however, only those performed or exhibited by tax-exempt organizations.
organizations or certain museums of cultural significance. The exemption took effect July 1, 2021, and runs through December 31, 2022.

States often carve out new exemptions to benefit specific industries or taxpayers, for one reason or another. Thus, as of November 1, 2021, Oklahoma sales tax doesn’t apply to certain sales of clothing to any Oklahoma chapter of a tax-exempt national organization, or to sales of tangible personal property or services to certain museums. On the other hand, some Nebraska lawmakers are working to broaden sales tax to many currently exempt services.

Some states do a good job of announcing rate and rule changes, but some don’t. If the Louisiana Department of Revenue has published information about the new exemption for diapers and feminine hygiene products, it sure hasn’t made it easy to find.

**STATES TWEAK OLD TAX LAWS TO FIT NEW TECHNOLOGY**

Whenever industry-disrupting products and services emerge, states must either determine how old tax laws apply, or adopt new laws.

For example, the Colorado Department of Revenue amended its tangible personal property rule in early 2021 to clarify that “the method of delivery does not impact the taxability of a sale of tangible personal property.” This enabled it to tax digital goods under existing policy. The Colorado Legislature later codified the new policy with the enactment of House Bill 1312. Scott Peterson notes that while the Department of Revenue thought their law worked, “the Legislature didn’t want to take any chances and enacted a new law.”

But sometimes, state lawmakers start from scratch.
Can digital ads be taxed?

One of the most controversial taxes to emerge recently is the tax on digital advertisements adopted by Maryland in early 2021. States being the copycats they are, similar taxes were subsequently introduced in several states, including Connecticut, Indiana, Montana, New York, Texas, Washington, Washington, D.C., and West Virginia.

Massachusetts is looking for the best way to tax digital ads, and its most recent effort is the most straightforward: Bill H.4179 would levy a 6.25% excise tax on gross revenue from digital advertising services by “persons with revenue from digital advertising services provided within the commonwealth.” To protect the smallest companies from the tax burden, the first $1 million earned from digital advertising services in Massachusetts each year would be exempt.

Otherwise, the Massachusetts plan is extremely light on details. There are basic enforcement issues to sort out, such as how to determine the location of the ad or which businesses and which sales these taxes will affect. Perhaps due to the enormity of the task, the Maryland Assembly left such details to the Maryland Comptroller to determine.

There’s no hurry: Maryland’s now fighting for the right to enforce its digital advertising tax. Two lawsuits are pending, one by the Chamber of Commerce of the United States of America and another by Comcast and Verizon. If other states pass similar laws, additional challenges will almost certainly arise.

Peterson believes “the constitutional challenges of taxing digital advertising and exempting all other forms of advertising are overwhelming.”

As states explore the best way to tax digital advertising services, other countries are adopting national digital
services taxes. However, if a new global minimum tax deal proceeds as planned, their fate is in jeopardy. Put forward by the Organisation for Economic Co-operation and Development (OECD), the plan will subject roughly 100 of the world’s largest and most profitable multinational enterprises to a minimum corporate tax of 15% starting in 2023. It will also require the repeal of national digital services taxes.

Whether the repeal would extend to state-level digital advertising taxes is unclear. It certainly could, especially since Maryland’s tax includes variable tax rates that increase along with the taxpayer’s global revenue. According to Peterson, “While still a long way off and far from certain, the OECD’s multinational negotiations on corporate tax reform will likely affect a state’s ability to tax.”

**Are online classes subject to sales tax?**

Though online learning certainly isn’t new, the pandemic took it to new levels. Seemingly overnight, education and exercise classes that could no longer be offered in person were reaching homebound students over Zoom and similar platforms. You lived it, you know. What you may not know is whether the taxability of such classes changed with the medium.

“Determining whether or not online education and training sales are subject to sales tax can be inherently complex,” explains Scott Peterson. Three main factors tend to impact taxability:

- **IS THERE AN INTERACTIVE COMPONENT (LIVE VS. PRERECORDED)?**
- **ARE TRAINING MATERIALS INCLUDED (DO YOU DOWNLOAD COURSE MATERIALS)?**
- **IS THE ONLINE EDUCATION CONTENT PURCHASED VIA SUBSCRIPTION?**
In Washington, for example, the taxability of online classes is often based on how much students can participate. Classes occurring in real time, where students and teachers interact, are generally exempt. Yet if real-time interaction isn’t possible, tax typically applies.

On-demand classes are often subject to sales tax in Colorado too, but digital educational content tends to be exempt from North Carolina sales tax. Similar to Washington, Wisconsin generally exempts livestreamed online educational services but taxes prerecorded seminars and videos.

The persistence of COVID-19 and the efficacy of online and hybrid classes will likely lead more states to reevaluate tax policies affecting online learning. In addition to the format and the type of program or school, tax officials will likely consider whether any taxable products are sold along with the class (as with wine tasting classes).

**Peer-to-peer car sharing**

The rise in peer-to-peer (P2P) car sharing services has prompted many states to wonder, should P2P car sharing companies be regulated and taxed like car rental companies, or are they different?

More than 40 states levy a specific excise tax or surcharge on car rentals according to the Tax Foundation, and that’s usually on top of sales tax. Fewer tax P2P car sharing services, though “there have been ongoing debates in over 30 states about whether and how to treat peer-to-peer car sharing within rental car excise tax regimes.”
Where state and local sales taxes do apply to P2P car sharing, it’s often through marketplace facilitator laws. Under Indiana HEA 1001 (2019), **marketplace facilitators are responsible for the tax on vehicles shared through their platform**. For transactions not made through such platforms, the vehicle owner is generally liable for the tax due unless the transaction is exempt from both sales tax and the vehicle sharing excise tax (e.g., the person shares the vehicle for fewer than 15 days in the current or preceding calendar year).

Some states, like Colorado, have exempted car sharing from daily car rental fees because car sharing can benefit the state “by reducing traffic congestion, greenhouse gas emissions, and the amount of wear and tear on the highways.” Yet other states, including **Florida** and **Nevada**, have opted to tax and regulate this disrupter.

Connecticut isn’t quite sure how to treat P2P car sharing transactions, but it’s **exploring the issue**. Meanwhile, the Arizona Department of Revenue added P2P car sharing to its **October 2021 tax rate tables**.

“Car sharing can benefit the state ‘by reducing traffic congestion, greenhouse gas emissions, and the amount of wear and tear on the highways.’”
NEW SOURCING RULES

Sales tax sourcing rules are also changing with the times. Sourcing rules dictate which sales tax rates and rules govern a transaction: those in effect at the location of the seller (origin sourcing), the location of the point of delivery (destination sourcing), or a combination of both (mixed sourcing).

Sales tax sourcing rules govern which jurisdiction’s rates and rules govern a transaction.

**Colorado changes sales tax sourcing rules**

_Colorado switched to destination sourcing_ from origin sourcing in 2019, when it began taxing remote internet sales. Any business making $100,000 or more in retail sales into Colorado during the previous calendar year is required to use destination sourcing rules, but the state allowed an exception for small businesses with less than $100,000 in retail sales in the state.

The exception for small sellers ends February 1, 2022. As of that date, all retailers must apply destination sourcing rules as follows (next page):
The Colorado Department of Revenue offers additional guidance for transactions not meeting the above descriptions.

**New Mexico adopts new sourcing rules**

New sourcing rules for gross receipts tax took effect in New Mexico on July 1, 2021. Most internet sales of tangible personal property (and certain services) are now taxed based on the destination of the sale, not the origin. If the consumer takes possession of the property at the seller’s place of business, origin sourcing rules continue to apply.

Sourcing sales of services in New Mexico can be a bit more complicated. Generally, the rate is determined by the location where the “product of the service” is delivered. Though that’s often the same location as where the service is performed, it isn’t always.

**Texas wants to change its sourcing rules but is stuck in legal purgatory**

Businesses located in Texas generally source internet orders to the seller’s place of business, not the location where the goods are delivered. Yet this has created a bit of a situation in the Lone Star State: Localities where internet sellers are located reap the sales tax revenue while localities where the buyers live get nothing. So, Texas decided to switch to destination sourcing for online orders starting October 1, 2021.
(unless the seller fulfilled the order at a place of business in Texas, in which case origin sourcing would still apply).

Localities benefiting from the current sourcing rules are challenging the new sourcing rules, so the policy change is on hold. It won’t be enforced unless and until validated by the courts. The case is expected to go to trial in June 2022.

NEW AND DIFFERENT SALES TAX FILING REQUIREMENTS

State and local governments also periodically change filing obligations.

Beginning January 1, 2022, certain business activities in Phoenix, Arizona, must be reported under new codes. For example, gross income from the retail sale/purchase of a single item of tangible personal property whose value is equal to or less than $11,631 (before taxes, add-ons, or sales price adjustments) is subject to the 2.3% tax rate. If the gross income exceeds $11,631, the 2.3% tax rate applies to the first $11,631, while any amount exceeding $11,631 must be taxed at 2% under a different code. Prior to January 1, 2021, the threshold was $10,968, not $11,631.

Colorado recently amended its timely filing discount (called a service fee or vendor fee). The 4% discount is available to all timely sales tax and use tax filers in Colorado through December 31, 2021, after which it’s only available to smaller businesses.

Under House Bill 21-1312, retailers with total taxable sales exceeding $1 million during a tax period may not retain any money to cover expenses incurred collecting and remitting Colorado sales tax for that period. Retailers whose taxable sales are under $1 million may retain 4% of their tax collections (up to $1,000 per month), to cover their tax-related expenses.
NEW AND UNUSUAL SALES TAX HOLIDAYS

Approximately 17 states typically offer one or more sales tax holidays each year. Sales tax holidays allow consumers to purchase certain products exempt from sales tax for a specific period of time. They can be a bit of a bear for the retailers required to temporarily suspend sales tax collections on certain sales, though they’re generally popular with consumers.

Illinois, Indiana, New Jersey, New York, and North Carolina all considered offering new sales tax holidays in 2021 or beyond, though none of the bills made it to governors’ desks. Arkansas, Florida, and Tennessee were more successful.

As in 2020, Tennessee offered a food sales tax holiday in August 2021 to help struggling businesses and consumers. Arkansas added certain electronic devices to the list of eligible items during its annual sales tax holiday, because “many students in the state have been forced to adapt to virtual education efforts as the result of school closures, personal health risks, and other factors.”

Florida took home the “Most Unbelievably Complicated Sales Tax Holiday” award for 2021. It’s one-time “Freedom Week” exempted the first $25 of the sales price of this, the
first $75 of the sales price of that, and so on. For example, the first $30 of the sales price of a camping lantern or flashlight was exempt from Florida sales tax between July 1 and July 7, 2021, but any amount over $30 was subject to tax. If most sales tax holidays are a bear for retailers, this one was a grizzly.

Sales tax holidays don’t just apply to retailers in the state – they affect any business registered for sales tax that sells eligible items. Florida’s Freedom Week must have felt like hazing for remote retailers required to register under the state’s new economic nexus law, which took effect July 1, 2021.

These are many of the issues affecting retailers today, though certainly not all. Some of these may affect manufacturers as well, especially those selling directly to consumers in one or more states. There are also distinct tax compliance matters for manufacturers.

Manufacturing

Manufacturers have always faced unique sales and use tax challenges, even during the best of times. The COVID-19 pandemic has only exacerbated the challenges. Though demand for goods is generally high, companies are having a hard time meeting it because of a worldwide shortage of both raw materials and labor.

According to The Manufacturing Institute, “the lack of skilled labor was the industry’s major challenge even before the pandemic ... [and] it’s still a major concern today.” In fact, 77% of manufacturers surveyed recently anticipate ongoing trouble attracting and employing skilled workers.
and the labor shortage is expected to reach approximately 2.1 million unfilled manufacturing jobs by 2030. Adding to the woes, many manufacturing facilities in Asia are still periodically shuttering due to outbreaks of COVID-19.

Thus, the Glasgow Distillery Co. is struggling to find glass bottles, labels, and the cardboard it needs to ship whisky once it’s ready to go; wait times for critical supplies have moved from six weeks to six months. And in September 2021, Daimler AG CEO Ola Källenius said the semiconductor chip shortage would likely affect its business into 2023. No wonder the Kiel Institute for the World Economy predicts economic growth to drop from 6.7% to 5.9% for 2021.

Much of the problem stems from the interconnected and interdependent nature of manufacturing today. Consider this: A producer of hot tubs in Utah sources parts from seven countries and 14 different states. The company estimates that to make one hot tub, roughly 1,850 parts “travel a cumulative 887,776 miles” – a winter storm in Texas, a lengthy wait at a port in China, or too little trucking capacity in Idaho can end up causing significant production delays.

Such supply chain issues can also impact sales and use tax compliance. For example, significant delays may compel a business to store inventory in transit in a new state. If that state taxes inventory in transit, as some do, that business could suddenly owe that state income tax. According to Scott Peterson, vice president of government relations at Avalara, “Most states with a corporate income tax view inventory as physical nexus.”

Alternatively, a company long used to operating in a “just-in-time mode” may find itself with an excess of some supplies while waiting for other critical inputs to arrive. The company could pull inventory to build out additional storage facilities or shelves and end up liable for use tax on that inventory.

“Delays may compel a business to store inventory in transit in a new state. If that state taxes inventory in transit, as some do, that business could suddenly owe that state income tax.”
And, of course, remote work policies can complicate exemption and resale certificate oversight when the certificates are on paper in an office. If no one is in the office due to stay-at-home orders, there’s no quick way to validate exempt transactions.

A 2019 study found that about one-third of business-to-business (B2B) customers said they preferred making at least 90% of their business-related purchases online. The pandemic has made the appeal of online business that much greater. This means manufacturers now need to be able to supply, collect, and validate exemption certificates online.

Even without the pandemic and any new tax issues it may spark, the manufacturing industry is a tough one for compliance. Because of this, it tends to be a prime target for auditors. In fact, many audits target just five industries:

- MANUFACTURING
- CONSTRUCTION
- WHOLESALERS AND DISTRIBUTORS
- RETAIL
- FOOD SERVICE

Some of the most common mistakes found by auditors typically involve:

- FAILURE TO REGISTER WHERE REQUIRED
- FAILURE TO REPORT CONSUMER USE TAX
- MISSING EXEMPTION CERTIFICATES AND OTHER DOCUMENT ERRORS
FAILURE TO REGISTER WHERE REQUIRED

The 2018 Wayfair decision and subsequent economic nexus laws can affect businesses that deal primarily or exclusively in exempt transactions because many states count certain exempt sales toward their economic nexus threshold. So, even if all your sales are exempt, you can develop an obligation to register with the state tax authority, validate exempt transactions, and file timely returns.

SELLING DIRECTLY TO CONSUMERS

Of course, nexus also comes into play when manufacturers cut out intermediaries and sell directly to consumers, becoming a retailer in addition to a manufacturer.

There are advantages to selling directly to consumers: It’s something consumers increasingly want, for one, and it can increase margins for producers. However, it should be done with eyes wide open, especially with respect to tax compliance.

Even if you make little in the way of taxable sales to consumers, your exempt sales into a state could establish nexus and an obligation to tax your non-exempt sales. To tax them correctly, you’ll need to know how to source sales and be able to calculate and remit the correct rate of tax for each transaction.

PAYING TAX TWICE

Nexus can complicate compliance in other ways as well.

For example, if you regularly buy from out-of-state companies, you may have systems in place to remit use tax on those transactions because the remote seller hasn’t been required to collect sales tax. If that system remains in place after the seller establishes nexus and begins charging sales tax, you could end up paying tax twice: sales tax to the retailer and use tax to the state.
FAILURE TO REPORT CONSUMER USE TAX

Like all businesses, manufacturers frequently have consumer use tax liability.

States created consumer use tax to capture revenue lost when tax isn’t collected on a taxable sale. Manufacturers often owe use tax when they use items purchased tax free for their own purposes, or when they move components purchased tax free in one state to a different state.

Source: Avalara Tax Desk

This self-assessed tax is generally considered harder to manage than sales tax because it often leads to:

- FAILURE TO REMIT USE TAX AS REQUIRED
- FAILURE TO ACCURATELY ASSESS THE LOCATION OF THE USE
- FAILURE TO ACCOUNT FOR A CHANGE IN USE THAT AFFECTS TAXABILITY
- FAILURE TO PROPERLY ACCOUNT FOR VARIOUS UNIQUE RULES AND CONDITIONS
Unfortunately, when mistakes are made, they tend to be made repeatedly, for years. As a result, a negative audit finding can lead to a hefty fine.

**MISSING EXEMPTION CERTIFICATES AND OTHER DOCUMENT ERRORS**

Companies with a lot of exempt transactions can benefit from a solid exemption certificate management system. The simple fact that different exemption certificates have different expiration dates in different states makes overseeing exemption certificates extremely difficult, especially for companies with thousands of certificates on file.

Depending on the size of your company and the number of exempt transactions made, you may need to collect and store 50 certificates, or 5,000. All need to be valid when collected and renewed before they expire, a fact complicated by the differing requirements in each state.

In Arizona, for example, both resale and manufacturing exemption certificates generally expire after one year, though some may be acceptable for up to 48 months. In Florida, resale certificates generally expire at the end of every year, while manufacturing certificates typically last five years. And in Colorado, manufacturing certificates never expire but resale certificates expire every two years.

Even if some certificates don’t expire, policies change. It’s best practice to validate them regularly so you can renew them if and when needed. If an exemption certificate you had on file with a vendor expires, an auditor may go after the vendor for the tax due. However, an auditor could also go after you for not remitting use tax on that transaction.
Validating certificates is critical, but it’s just one part of the process. Filling out forms is another, and it can be surprisingly difficult. According to Maria Tringali, senior solutions consultant at Avalara, there are 2,000+ available exemption certificates across the U.S. and 16,000 fields to consider – and that doesn’t include nonstandard forms. Tringali recommends leveraging a compliance tool for collecting certificates and validating these fields, as the task is tedious and time-consuming for employees.

It’s worth noting that manufacturers may need to file zero returns in states where they make only exempt sales. A zero return lets the tax authorities know companies were doing business in the state but not collecting tax because none was due. Zero returns are required in many states, including Virginia, and failure to submit a zero return can result in penalties and interest.

NEW AND DIFFERENT TAX CREDITS

Research and development (R&D) tax credits and/or sales tax exemptions for manufacturing equipment can also complicate compliance, particularly since they vary considerably from state to state.
For example, South Carolina provides numerous sales and use tax exclusions and exemptions for “manufacturers, processors, and compounders.” Typically, whether a machine is exempt depends on the “circumstances and use of the machine.”

A machine is generally exempt from South Carolina sales tax if it’s “an essential and indispensable component part of the manufacturing process and is used on an ongoing and continuous basis during the manufacturing process.” It doesn’t necessarily apply to “everything that can be useful to a manufacturer.” Determining whether the exemption extends to replace parts and attachments adds another layer of complexity.

By contrast, manufacturing machinery is generally taxed at a reduced rate in California. To qualify for the lower rate, a business must meet all following conditions:

- **BE PRIMARILY ENGAGED IN CERTAIN TYPES OF BUSINESS**  
  i.e., be a “qualified person”

- **PURCHASE “QUALIFIED TANGIBLE PERSONAL PROPERTY”**

- **USE THAT QUALIFIED TANGIBLE PERSONAL PROPERTY IN A QUALIFIED MANNER**

Some of the fine print: The law provides that purchases subject to the partial exemption cannot exceed $200 million in any calendar year. There’s no proration, so if you begin business operations in October, you may claim up to the $200 million cap for that year. However, you cannot carry over any unused amount to the following year.

It’s the responsibility of each business to track the amount of qualifying purchases made in a calendar year. California will hold a company liable for the full sales tax on any purchases exceeding the $200 million limit.
To make matters more complicated, states sometimes change their policies. Kentucky recently created sales tax and gross receipts tax exemptions to stimulate the development of cryptocurrency mining in the state. Wisconsin is considering an exemption for materials used to construct workforce housing developments or conduct workforce housing rehabilitation projects.

These are just some of the factors manufacturers encounter when dealing with sales and use tax. Companies in the software industry face others.

Software and software services

Surely even Luddites must concede the advantages of software and software services after living through the darkest days of the pandemic. At times, the only way to interact with certain industries – and friends or family – was through the internet. COVID-19 hastened the digital transformation to such an extent that the United Nations Conference on Trade and Development (UNCTAD) believes, “we will look back at 2020 as the moment that changed everything.”

In its global review of COVID-19 and ecommerce, UNCTAD noted, “The COVID-19 pandemic has accelerated digital transformations. Digital solutions are increasingly needed to continue some of the economic and social activities remotely. They have been critical for telemedicine, telework and online education, not least to keep alive our social ties in times of physical distancing.”

Given the current conditions, businesses that provide and sell digital goods and services must know how to tax them. Unfortunately, that’s no simple task. Because software
technology evolves more quickly than tax policy, old laws often don’t neatly fit new products and services.

The 45 states with a sales tax, plus Washington, D.C., categorize software up to 10 different ways for tax purposes. As a result, it can be extremely difficult to determine the taxability of specific software products and services from state to state. Whether sales tax applies or doesn’t apply to software transactions in a particular state depends on several factors, including but not limited to:

- **Is it canned or custom?**
- **Is it digital or physical?**
- **Is it stand-alone or does it come with a service (bundled)?**

Who buys the software can also affect taxability, as can how it’s delivered, how it’s classified, what it’s for, and where the seller and end user are located.
It’s hard to generalize tax laws related to software sales, because every transaction is unique. That said, canned software delivered in tangible form for business use is generally taxable in California. On the other hand, canned software for business use that’s delivered electronically in California is generally exempt, and canned software used in manufacturing or research and development is generally taxed at a reduced rate. Canned software delivered electronically for business use is also usually exempt in Florida, but it tends to be subject to sales tax in Ohio, New York, Texas, and several other states.

Tennessee typically bases the taxability of data processing and information services on the “purchaser’s primary purpose for the underlying transaction.” In Letter Ruling #21-08, the Tennessee Department of Revenue decided the primary purpose of a company’s online platform was the data the company processed and shared, not the service of processing and sharing the data.

This has to do with how digital products and services are classified. The company in question operates an online cloud-based platform, which commercial freight brokers and carriers use to post and search opportunities and determine the fair market value of freight hauling. The department concluded the services should be classified as exempt data processing and information services rather than taxable telecommunications services or software.

**SOURCING SALES OF DIGITAL GOODS**

If tax does apply to a software transaction, it needs to be applied at the proper rate. Determining the rate can be difficult if a seller doesn’t collect a buyer’s full address, and software companies often collect only a consumer’s five-digit ZIP code because with nothing tangible to deliver, they don’t need the delivery address. Yet it’s impossible for a business to calculate a sales tax rate with rooftop-level
accuracy — or for a tax authority to confirm that tax was properly collected — if the location of the roof isn’t known.

The **Streamlined Sales Tax Governing Board** (SSTGB) is currently **reevaluating its sourcing rules for digital goods and services** with this problem in mind. It notes that even if sellers request the full address, “some purchasers may refuse to provide the information since it really is not needed to receive the product or because of the type of product being purchased the purchaser does not want to provide their address.”

A federal Digital Goods & Services Tax Fairness Act could help promote simplicity and fairness in the taxation of digital goods and services, and **several bills** have been introduced over the years. Yet since Congress appears “reluctant” to interfere with state and local tax issues, the SSTGB is urging states and the software industry to address this issue themselves.

The SSTGB surveyed the 10 Streamlined Sales Tax (SST) member states that tax digital goods (it didn’t survey member states with no local sales and use tax or those that don’t tax digital goods). Based on the responses, it recommends collecting at the highest combined state and local tax rate in the 5-digit ZIP code if the seller doesn’t obtain a complete street address or 9-digit ZIP code, and reporting the sale as occurring in any jurisdiction with that highest rate. If multiple local jurisdictions within a 5-digit ZIP code have the same highest rate, the seller could report the tax as being collected in any of those jurisdictions.

The SSTGB further recommends holding the seller liable for tax if it doesn’t obtain a complete street address or 9-digit ZIP code tax from the consumer and doesn’t collect the highest possible tax due. The board offered several other
options as well. It’s been studying this issue for years and will likely continue to do so in 2022.

According to Scott Peterson, “The challenge for sourcing digital goods is they can be used in multiple locations and the seller often doesn’t know where the buyer uses the goods.”

**BUNDLING DIGITAL GOODS AND SERVICES**

States will also likely pay more attention to transactions that bundle digital goods and services in the coming months and years.

Determining the taxability of bundled products and/or services is always difficult, even when the products are tangible. Tennessee Department of Revenue Letter Ruling #21-04 reinforces that the complexity extends to the digital economy.

The department ruled sales tax applies to sales of subscription packages that contain at least one taxable item and are sold for one non-itemized price. But whether the company should report tax upfront, on the lump sum, or on a monthly or periodic basis depends on the terms of the sale.

Letter rulings are applicable only to the individual company being addressed, but they can be instructive for all businesses because they illustrate the types of questions tax departments ask when determining the taxability of goods or services.

**THE TAXABILITY OF SOFTWARE ISN’T SET IN STONE**

Sometimes, the taxability of a sale depends on who you ask. As more transactions occur online, more states will scrutinize them – some with an eye to tax them.
According to the Mississippi Department of Revenue, for example, sales of digital photographs are generally taxable. After a digital photographer challenged an assessment, the Mississippi Board of Tax Appeals reached the same conclusion as the department. Yet, the Mississippi Supreme Court disagreed, noting that neither photography services nor digital photography have been added to Mississippi’s list of taxable “specified digital products.”

Scott Peterson reminds that “generally, the burden to prove a purchase or sale is exempt falls on the person seeking the exemption,” while “the burden to prove something is taxable falls on the state.” Thus, as the department appeals the Supreme Court’s decision, it’s also working to clarify that sales of specified digital products by photographers and videographers are taxable.

Tax departments can also change their minds. For example, the West Virginia State Tax Department recently clarified that streaming services are taxable although earlier guidance suggested streaming services were exempt. Digital products are generally exempt from West Virginia sales and use tax.

The department noted, “West Virginia imposes a sales tax on the provision of services. The provision of streaming services is subject to this tax. However, rentals and similar nonpermanent use of digital audio visual works are not subject to this tax.”

In TSD-445, the West Virginia State Tax Department clarifies the difference between the two. A taxable streaming service provides “access to curated entertainment content in the streaming service’s catalog.” By contrast, an exempt digital product is “a discrete identifiable item” that can be purchased or rented.
The Mississippi Department of Revenue is also interested in expanding sales tax to certain cloud computing services, including Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS). The department says it’s amending the rule to “clarify the tax treatment of computer software sales and services when delivered through cloud computing,” though it seems the proposed rule would in fact change how the state taxes such sales.

Although the tax treatment of digital goods and services is still often shrouded in incertitude, states will figure it out. They must, because cloud computing isn’t going away. Perhaps with that in mind, the Multistate Tax Commission (MTC) is working toward “identifying potential best practices and areas for increased uniformity” for taxing digital products. It’s particularly interested in what it calls “The Washington Approach.”

In a nutshell, Washington state taxes broad categories of digital products and services then provides for a number of specific exclusions. It finds this practical in part “because the alternative – specifically identifying particular products for inclusion in the tax base – creates a system that becomes outdated quickly as technology changes and requires continual updating.” This, of course, can “create compliance and enforcement difficulties.”

In studying the issue, the MTC has identified the following concerns:

- A LACK OF UNIFORMITY IN SOURCING MAY LEAD TO “NOWHERE SALES OR TO SALES SUBJECT TO MULTIPLE TAXATION”
- “EXPANSION OF THE SALES TAX BASE MAY EXACERBATE ... THE REGRESSIVITY OF THE TAX”
- “DIGITAL PRODUCTS MAY BE TOO DIFFICULT TO CONSISTENTLY DEFINE, WHICH WILL ONLY INCREASE THE OVERALL COMPLEXITY OF THE TAX SYSTEM”
This is a complicated issue, and it’s not going to get any simpler. As digital goods and services evolve and replace more traditional products and services, they’ll likely become even more prevalent. The MTC believes “the issue affects all states (regardless of whether they do or do not tax some digital products currently) and also the vast majority of taxpayers who may buy or sell these products.”

**SPECIAL CONCERNS FOR REMOTE PROVIDERS OF DIGITAL PRODUCTS AND SERVICES**

The MTC also thinks states may be more interested in taxing digital products and services now because they have the authority to tax remote sales. Any future tax efforts will be complicated by the fact that “few states will be writing on a clean slate. The MTC’s past experience suggests that it is particularly difficult to bring about uniformity where individual states have already committed to diverse approaches.”

This, of course, can make sales tax compliance extremely challenging for all taxpayers in the industry. There are also particular ramifications for out-of-state sellers because of economic nexus: Companies need to know which sales count toward states’ economic nexus thresholds.

Though West Virginia’s economic nexus threshold doesn’t specifically include or exclude intangible property, digital goods, or streaming services, the West Virginia State Tax Department now says streaming services do count toward the state’s economic nexus threshold. This will likely impact many streaming service providers’ nexus footprint.

Changing state tax policies as they relate to certain digital goods and services will take time, but there will likely be movement on this issue in 2022 because taxing sales of digital products is proving to be an excellent source of revenue. For example, Chicago’s controversial “Netflix tax” on streaming services more than tripled between 2016 and 2021 and
increased by more than $30 million during the 2020–2021 fiscal year, when Chicagoans were at home due to COVID-19.

Explore tax changes affecting the hospitality, beverage alcohol, communications, tobacco, and energy sectors in 2022, as you continue reading the industry tax changes section.

Hospitality

COVID-19 will almost certainly continue to disrupt hospitality and tourism in 2022, but if the past is a harbinger of future trends, people will travel if they can, when they can, and how they can. Hospitality businesses able to adapt to new challenges and meet changing consumer demands will be most successful.

What the numbers tell us:

The U.S. lodging industry likely experienced losses totaling approximately $1.3 billion in 2020

$1.3B

$1.45B

Rooms revenue in 2021 is expected to drop $1.45 billion from a baseline scenario (i.e., with no pandemic)

Source: HVS
What the numbers tell us (continued)

32% of American travelers surveyed in September 2021 said they were choosing destinations they could drive to rather than fly

Source: Longwoods International

Total labor costs in the U.S., as a percentage of total hotel revenue, jumped from 37.4% (April 2019-March 2020) to 60.5% (April 2020-March 2021)

Source: HospitalityNet

The hotel industry is projected to end 2021 with $59 billion less business travel revenue than in 2019

Source: American Hotel & Lodging Association

Only 25% of businesses polled in September 2021 planned to resume domestic business travel in the next three months

Source: U.S. Travel Association
COVID-19 aftershocks

The pandemic’s effect on the hospitality and tourism industry has been monumental, with year-over-year travel spend dropping by 42% (almost $500 billion) in 2020. The hotel industry is expecting to have $59 billion less business travel revenue in 2021 than in 2019. These are difficult times.

Though travel for leisure seems to be bouncing back, business travel is still lagging. This is concerning because “business travel is the hotel industry’s largest source of revenue.” The American Hotel & Lodging Association (AHLA) predicts business travel revenue won’t reach pre-pandemic levels until 2024, and McKinsey & Company expects overall corporate travel spending to decline even as business travel resumes.

But there are hopeful signs on the horizon. Travel spending in the United States improved steadily January through July 2021 before dropping a bit in August.

Source: U.S. Travel Association
Research commissioned by SAP Concur (April through May 2021) suggests global business travelers are ready to get back on the road.

*Every company’s travel recovery will look different*

**EXAMPLES OF APPROXIMATE SPENDING ON TRAVEL, IN $ MILLIONS**

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Source: McKinsey & Company

96% of global business travelers are willing to travel for business over the next 12 months (65% are very willing)

**WILLING**

- 96%

**VERY WILLING**

- 65%

80% of business travelers fear their professional lives will suffer if they don’t increase business travel

Source: SAP Concur
Until travel returns to its pre-pandemic heights, some hospitality businesses are finding creative ways to fill rooms and cater to what customer demand there is. Whenever new processes or business models are adopted, it’s important to keep compliance top of mind.

**STAFFING CHALLENGES AND THE RISE OF ROBOTS**

Like many businesses in the service sector, the hospitality industry is experiencing a labor shortage. According to AHLA, “Hotels are expected to end 2021 down nearly 500,000 jobs compared to 2019.”

With fewer bodies available to handle essential tasks, guests at some hotels are going without turndown service or other amenities. And in some hotels, guests are getting help from a new source: robots.

Robot employees in hotels aren’t new. Starwood Hotels (since acquired by Marriott) explored the use of robots in...
2014, launching a butler named “botlr” in a Silicon Valley hotel. Once COVID-related travel restrictions eased a bit, the hotel chain began offering The Bot Experience, a hotel deal that comes with an in-room robot.

The Japanese Henn na Hotel invited robots into the workforce in 2015. They were “hired” to answer questions, clean rooms, mix cocktails, store luggage, and perform other essential (and nonessential) tasks. But things didn’t work out quite as planned, and by 2019, the hotel had decided to “lay off more than half of its 243 robots.”

In addition to filling staff vacancies and potentially improving operational efficiency, robots may cater to guests’ desires for less interaction during a pandemic; they certainly eliminate awkward interactions with porters lingering to secure a tip. Robots can sterilize spaces in a way human counterparts can’t. And robots don’t ever ask for a raise or time off.

So, robots could be a win-win for hotels and their guests.

Yet there are potential downsides. Many travelers enjoy casual interactions with hotel staff, and such social contact may hold even more appeal in a post stay-at-home-order world. Employees who are concerned robots will eliminate jobs or erode their bargaining power could strike, like workers in Las Vegas did in 2018, further exacerbating staffing woes.

If hotels use robots to sell food, beverages, or other items to guests, they’ll need to figure out how to calculate the tax due on those sales. Pamela Knudsen, senior director of compliance services at Avalara, explains: “Tax on those sales will need to be calculated either ‘by’ the robot at the time of purchase or included in the cost of the product and then netted out in order to remit. The technology will need to exist for this information to be passed back and forth.”
HOTELS THINK OUTSIDE THE BOX TO FILL ROOMS

HOTEL AS HOSPITAL

With hotel occupancy down and hospital occupancy up, hotels the world over started catering to a new type of guest during the first wave of the pandemic: asymptomatic or mildly ill COVID-19 patients. Hotels have also housed first responders and healthcare professionals.

It’s brilliant, really, and it gave sorely needed revenue to hotels at a time when most people weren’t traveling for business or pleasure. Michael Jacobson, CEO and president of the Illinois Hotel and Lodging Association, said the money the city of Chicago paid to lease all the rooms in several hotels during the spring of 2020 was “the bare minimum just to break even.”

These programs can also come with tax implications since lodging taxes usually apply to stays of less than 28 or 30 consecutive days. Do lodging taxes extend to long-term guests who are ill, quarantining, or caring for ill people? Should they? Answers may vary from state to state, or by city within states, and Knudsen says some jurisdictions are looking to change that time frame from 30 days or less to 60 or 90 days or less to offset this trend.

HOTEL AS OFFICE OR SCHOOL

The InterContinental New York Times Square served as temporary housing for medical staff in the spring of 2020. After those guests left, it turned some rooms into office space. Across the country, a Beverly Hills hotel transformed rooms into work spaces.

Some creative hotels catered to desperate parents whose children were in remote school: Five families rented a conference room in a Courtyard by Marriott hotel in Illinois so their kids could have a pseudo-classroom.
experience. A Great Wolf Lodge in Pennsylvania offered remote-learning facilities.

Do lodging taxes, rental taxes, or other taxes apply to rooms rented as office space by the day, or to a meeting room used as a school? Should they? Does a hotel meet the definition of a hotel if it’s acting like an office or WeWork location? Any time traditional operations are altered, possible tax or compliance ramifications must be taken into consideration.

Knudsen hasn’t heard of any legislation that would change the taxes if someone uses their room as an office because they’re still using it as lodging. However, she believes lodging establishments that provide a separate working space for guests will appeal more to people who can work from anywhere.

**FEEDING GUESTS: TAX DEPENDS ON WHAT YOU SERVE AND HOW YOU SERVE IT**

Though restaurants across the country and around the world are once again open for in-person dining, some people are still uncomfortable eating in restaurants. In its September 29, 2021, tracking study of American travelers, Longwoods International found that 20% of respondents disagreed or strongly disagreed with the statement, “I would feel safe dining in local restaurants and shopping in retail stores within my community.”

Hotels offering alternatives to in-person dining, such as room service, will appeal to some travelers. Those properties able to elevate alternate dining options will fare even better.

Whenever a business sells food or beverages – especially prepared food and alcoholic beverages – taxes mustn’t be overlooked. The taxes on these products can be quite different from hotel and occupancy taxes.
For example, sales of prepared food are often taxed at a different rate than food for home consumption (which hotels may also sell). Thus, a salad sold through a hotel restaurant would likely be taxed differently than a banana sold at the gift shop.

Sales tax generally doesn’t apply to prepared food that’s given away (e.g., a complimentary cookie or continental breakfast), but use tax might: It would depend on the state. In Washington, for example, “A hotel’s purchases of food and food ingredients used in complimentary meals served only to hotel guests are not subject to retail sales tax at purchase because they are purchased for resale, and their subsequent intervening use is not subject to use tax pursuant to the statutory exemption for food and food ingredients.”

Chicago levies a special tax on bottled water, and in some parts of the country and world, sweetened beverages like soda are taxed differently than unsweetened teas. Candy is sometimes subject to different tax rates than other foods. And coffee? Taxability can hinge on whether it’s hot or cold, prepared or prepackaged, and whether the seller provides a place to sit and drink it. There’s a lot to keep track of.

Then there’s alcohol. Often subject to sales and use tax, beverage alcohol can be subject to alcohol excise tax, excise tax, liquor excise tax, liquor luxury tax, or other taxes, depending on state and sometimes local jurisdictions. How the alcohol is served or sold must also be taken into consideration. A bottle of wine sold at the gift shop could be taxed differently than a bottle of wine sold through room service. A glass of wine or martini at the bar may not be taxed the same as a ready-to-drink (RTD) cocktail or bottle of beer sold through the in-room minibar.

Other considerations: When a room-service order contains beer or wine, can an 18-year-old employee carry it to the room? Are tips subject to sales tax? What about mandatory
service fees? And are there special licensing requirements for alcohol sales? Businesses in the hospitality industry must consider these and other factors before expanding menu options or offering new items to guests.

**ENTERTAINING GUESTS: STREAMING TAXES COMPLICATE TAX COMPLIANCE FOR THE HOSPITALITY INDUSTRY**

If you run an ice hotel in Scandinavia, your guests may be more interested in watching the northern lights than an episode of “Ted Lasso.” However, guests may expect most hotels to come with free Wi-Fi and streaming services so they can stay connected to the office or school and enjoy movies, sports, or favorite shows.

As with all other goods and services hospitality businesses provide, streaming and internet services are generally subject to tax. And unfortunately, these can compound the complexity of transactional tax management. This is especially true for companies with properties in multiple tax jurisdictions, because taxes on streaming services vary considerably from place to place and sometimes involve taxes other than just sales tax.

For example, there’s a 9% amusement tax on streaming entertainment in Chicago and an excise utility tax on streaming services in Kentucky. Several jurisdictions in California impose a local utility use tax on streaming services, though they’re being challenged for doing so. A dedicated communications services tax applies to streaming subscriptions sold in Florida.

Furthermore, many states still haven’t settled on how to tax streaming services. Thus, the Colorado Department of Revenue decided certain digital goods and services were subject to sales tax as of January 30, 2021. A few months later, Governor Jared Polis signed a bill specifying that...
monthly subscription fees for internet streaming services and electronic downloads are taxable. And West Virginia recently clarified that although digital products are exempt from sales and use tax, streaming services are subject to tax.

More information about taxes on streaming services can be found here.

Unique concerns for short-term rentals

Depending on the amenities and services offered, short-term and vacation rental owners and operators may also need to deal with beverage alcohol taxes, consumer use tax, food taxes, parking taxes, sales and use taxes, streaming taxes, and a host of other taxes (e.g., business personal property tax on certain equipment).

At a minimum, hosts need to know which taxes are applicable. For example, if you charge a cleaning fee, is that fee subject to sales tax? If you add a separate charge for parking, is there a parking tax? Stuff like that.

Lodging and occupancy taxes cannot be overlooked, of course. Requirements vary considerably from state to state and, within states, from address to address. Many local jurisdictions impose local lodging taxes on top of state taxes, so it’s important to always verify requirements with local governments.

In some states and localities, Airbnb, Vrbo, and similar online platforms or marketplaces may be required to collect and remit applicable occupancy taxes on behalf of their hosts – though hosts generally remain responsible for other
state and local tax obligations. In others, hosts bear the full burden of tax compliance responsibility. If you book through multiple sites, including your own website, you need to be sure these taxes are collected and remitted as required.

Source: HVS

It’s also important to keep your finger on the pulse of changing tax requirements. For example, one bill introduced in Michigan in October 2021 would impose a statewide 5% excise tax on short-term rentals; another measure being discussed in the Wolverine State would allow local governments to tax short-term rentals.

Lastly, there’s an existential crisis in the short-term rental industry: Should they even be allowed to exist? And if so, which jurisdiction (state or local) should govern them? These types of discussions have been going on for years and they’re unlikely to go away in 2022.

Some local governments are keenly interested in gaining more control over short-term rentals. A bill under consideration in Florida would give cities and counties more control over vacation rentals starting July 1, 2022. Currently, local laws, ordinances, and regulations in Florida
cannot prohibit vacation rentals or regulate the duration or frequency of stays. House Bill 6033 would give localities the authority to do just that.

On the other hand, there are calls to restrict how much local governments can regulate the short-term rental industry. Michigan House Bill 4722 would prohibit local governments from banning short-term rentals.

“Communities struggling to accommodate both proponents and detractors of short-term rentals need to educate the community about their benefits and the potential negative impacts of banning them,” says Knudsen. “They should also enforce compliance regulations that help ensure short-term rentals are good neighbors.”

More details about state and local short-term rental tax rules can be found here and in our lodging tax blog.

HOW ROOMS ARE BOOKED AFFECTS HOW THEY’RE TAXED

Some states started requiring online travel sites like Airbnb and Expedia to remit taxes on behalf of hosts years ago. Now, local jurisdictions want in on the game. Many local governments today have their sights set on large online travel agencies (OTA) and marketplaces. This is a second wave of compliance regulation, and it’s hitting some businesses hard.

According to Knudsen, “The definition of a ‘marketplace’ continues to expand not only to platforms such as Airbnb or Vrbo, but also to property management groups. Whereas before, property managers managed bookings, cleaning, repairs, etc., they’re now increasingly required to collect and remit on behalf of the owners of the properties they manage. This entails developing a whole new area of expertise in the calculation, collection, and remittance of a multitude

<table>
<thead>
<tr>
<th>AIRBNB CONSUMER</th>
<th>SURVEY ON TRAVELING</th>
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<tbody>
<tr>
<td>43%</td>
<td>I see traveling as specific trips I might take, like a work trip</td>
</tr>
<tr>
<td>39%</td>
<td>I see traveling more as a lifestyle</td>
</tr>
</tbody>
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Source: Airbnb
of taxes at both the state and local level. In addition, many jurisdictions are requiring marketplaces to enforce compliance or exclude noncompliant properties from their site. The fines levied on these marketplaces for not ensuring the listed properties are in compliance can be quite hefty."

West Virginia lawmakers passed a bill in 2020 that required marketplace facilitators to collect and remit local lodging taxes in the state. The measure ended up being vetoed by Governor Jim Justice over technical flaws, but proponents intend to try again.

A similar effort in Virginia was more successful. Starting September 1, 2021, Virginia requires retail sales and use tax to be calculated “based on the total charges or the total price paid for the use or possession of transient lodgings, including any fees charged by accommodations intermediaries for the facilitation of transactions for the provision of transient accommodations.” OTAs and marketplaces are now the dealer liable for any tax due, including local taxes that may need to be remitted directly to the locality.

The decrease in short-term rental and hospitality tax revenue is driving some of this interest. Oliver Hoare, general manager of lodging at Avalara, explains: “With less funds in a typical year, the pressure on compliance within lodging and hospitality is going to be laser focused. At the same time the lack of occupancy in some channels (e.g., hotels) is forcing companies to think more about how to be more efficient.”

“With less funds in a typical year, the pressure on compliance within lodging and hospitality is going to be laser focused. At the same time the lack of occupancy in some channels (e.g., hotels) is forcing companies to think more about how to be more efficient.”
These are some of the many factors affecting the hospitality industry today. Others include:

- Cancellation policies. With COVID-19 still a threat and travel restrictions in play, travelers want the ability to cancel or reschedule lodging reservations without penalties. Understanding how to handle tax for full and partial refunds is critical.
- COVID-19 testing for employees. If an employer requires its employees to obtain a COVID-19 test, who pays for it?
- COVID-19 testing for guests. Many travelers need to show a negative COVID-19 test to travel home, and lodging establishments that provide such a service will have a competitive advantage over those that don’t. Yet what are the privacy concerns, contact tracing requirements, and potential tax implications of offering COVID-19 tests?
- Tax relief. Most pandemic-related tax relief for the hospitality industry has expired, but more could be adopted as the pandemic drags on.

To stay on top of tax changes affecting the hospitality industry, stop by the Avalara Tax Desk.

Beverage Alcohol

For the beverage alcohol industry, 2021 was fraught with challenges and rife with opportunities. These will likely continue into 2022.

In the coming months, we expect to see more activity when it comes to

- Direct-to-consumer sales
- Fulfillment houses
- Delivery apps and third-party providers
- Cocktails to go
What the numbers tell us:

- **In 2020, 80% of no/low-alcohol beer, wine, and ready-to-drink (RTD) products were purchased off premises.**

- **Hard seltzers will potentially account for 50% of global RTD sales by 2025 (up from 30% in 2020).**

- **Alcohol ecommerce sales in the U.S. likely experienced 3-5 years’ worth of growth in just 6 months.**
Let’s get to it.

**Direct-to-consumer channel wars**

Expect a lot of ink to be spilled on direct-to-consumer (DTC) sales in 2022, for several reasons.

The wine industry has long dominated this channel, with **wineries currently shipping to roughly 97% of the U.S. population**. Every state where DTC wine shipments are permitted can have unique registration and tax requirements as well as volume limits. For example, **Washington, D.C.**, doesn’t require remote wineries to obtain a special permit to ship DTC, while **Hawaii** does; in fact,
there’s actually a license for each county in Hawaii. See our **state DTC wine shipping rules** for state-specific details.

The only two states that fully prohibit wineries from shipping directly to consumers are Mississippi and Utah, and both are moving toward allowing DTC shipments: Mississippi allows wineries to ship directly to a licensed package retailer on behalf of a purchaser, and Utah will soon allow the Department of Alcohol Beverage Control to purchase wine subscriptions on behalf of individuals. Baby steps, but steps nonetheless.

**DTC privileges for breweries, distilleries, and even retailers** lag far behind their wine-producing counterparts. As of November 2021, breweries can ship DTC in nine states and Washington, D.C. Distilleries can do so in six states plus D.C., while retailers can ship DTC in 13 states, plus D.C.
STATES WHERE BREWERIES CAN SHIP DIRECTLY TO CONSUMERS

- Alaska
- Kentucky
- Nebraska
- New Hampshire
- North Dakota
- Ohio
- Oregon
- Vermont
- Virginia
- Washington, D.C.

STATES WHERE DISTILLERIES CAN SHIP DIRECTLY TO CONSUMERS

- Alaska
- Arizona
- Kentucky
- Nebraska
- New Hampshire
- North Dakota
- Washington, D.C.

STATES WHERE RETAILERS CAN SHIP DIRECTLY TO CONSUMERS

- Alaska
- California
- Connecticut
- Florida
- Louisiana
- Nebraska
- New Hampshire
- New Mexico
- North Dakota
- Oregon
- Virginia
- Washington, D.C.
- West Virginia
- Wyoming

Source: Avalara Tax Desk
Already operating at a disadvantage in this space, breweries, distilleries, and retailers recently lost a little ground. Nevada took itself off the short list of states where breweries, distilleries, and retailers can ship DTC; as of July 1, 2021, only wineries can make DTC shipments into the Silver State. And though it was widely believed retailers could ship directly to consumers in Idaho as long as their home state allowed Idaho retailers to do the same, Idaho recently made clear it has no such reciprocal arrangements; retailers cannot ship to Idaho consumers.

With the battle lines drawn, breweries, distilleries, and retailers will push for advancements in this area in 2022. Distilleries are on the front lines. Jeff Carroll, general manager of beverage alcohol at Avalara, believes retailers, breweries, and distilleries will all make a push to add more states to the mix next year. “But the spirits industry seems especially prepared to make substantive progress in 2022.”

**NEXT BIG PHASE OF DTC COULD BE SPIRITS ...**

This could be the right moment: When Kentucky authorized DTC shipments for wineries in 2020, it also opened the DTC market to Kentucky breweries and distilleries; several states temporarily authorized direct shipments of spirits during COVID-19 lockdowns, and Colorado, Connecticut, Maryland, and Virginia still allow them. There’s also support in California for Senate Bill 620, which would grant direct shipper permits to distilleries and beer manufacturers.
According to Chris Swonger, president of the Distilled Spirits Council of the United States (DISCUS), “**There is great consumer demand for DTC shipping.**” DISCUS has joined forces with the American Craft Spirits Association (ACSA) and the American Distilling Institute (ADI) to “persuade the U.S. government to pass DTC shipping laws.” They believe doing so is imperative to the “continued growth of the craft distilling movement in the U.S.”

Beer manufacturers seem less likely to make an aggressive push for DTC shipping privileges; though the Brewers Association publicly supports changing DTC laws, Beer Institute hasn’t declared the same. DTC shipping holds greater appeal for higher-priced items than the average can or bottle of beer. Jeff Carroll predicts **it will take at least 15 years for breweries** to gain access to the number of states currently open to wineries. Yet he encourages breweries to help move the needle by building out the market in their home states with subscription programs, ecommerce sites, and onsite shipments from tasting or tap rooms.

**... AND SPARKS ARE ALREADY FLYING**

Though there’s a push for more DTC sales of beer and spirits, growing DTC shipping privileges won’t be easy. As **spirits trade groups work together** toward expanding DTC shipping, opposition to all DTC beverage alcohol shipments — including wine — is mounting.

Some wine wholesalers and their industry partners worry direct shipping “**dismantles effective regulatory oversight**” because it bypasses the second tier of beverage alcohol’s long-standing **three-tier system of checks and balances** (next page):
The Supreme Court of the United States has even been asked to weigh in on the DTC issue. In 2021, the Supreme Court allowed a Michigan law banning direct wine shipments from out-of-state retailers to stand, although in-state retailers can ship directly. And in October 2021, the court decided not to hear a challenge to a Missouri law banning DTC alcohol sales from out-of-state retailers.

We anticipate more clashes over the future of DTC shipping in the months ahead.

Where DTC shipping is allowed, compulsory licensing, product registration, and state-by-state shifts to jurisdictional tax systems will increase operational stress on businesses interested in expanding their DTC footprint, particularly smaller producers. Economic nexus laws requiring out-of-state sellers to register then collect and remit sales tax, and marketplace facilitator laws that pass those obligations on to marketplace providers, will be additional stressors.

Altogether, the complexity of complying with beverage alcohol tax and sales tax requirements could be a major hurdle to business expansion in 2022.
Putting the cap on the last capacity caps

Another issue that could get some attention in 2022 is capacity caps. With Ohio having eliminated capacity caps on direct-to-consumer sales, New Jersey is the only state in the nation that still has them.

As the name suggests, a “capacity cap” caps capacity. In the beverage alcohol industry, the cap is one threshold for who can get a license and who cannot. A producer can’t get a license if it’s over the cap, so any wineries producing more than 106,000 cases of wine per year cannot get a license to ship DTC in New Jersey.

By limiting who can ship into the state, the capacity cap also takes a bite out of New Jersey’s tax revenue potential. Little wonder the Garden State is under increasing pressure to eliminate its capacity cap for wineries.

While capacity caps currently affect just one state, all states are grappling with how to regulate delivery apps and third-party providers.

The growth of delivery apps and marketplaces

Alcohol delivery isn’t limited to restaurants and bars. In parts of the country, consumers can have beer, wine, and spirits delivered from retailers such as convenience, grocery, and liquor stores, sometimes within an hour. As of September 2021, DoorDash offers 30,000 different beverage alcohol products in the U.S., Canada, and
Australia. Drizly (which was acquired by Uber in October 2021), Instacart, and a growing number of other companies offer similar services. We may never need to leave home again.

For the most part, states have yet to fully digest the impact on-demand delivery apps and third-party providers (TPPs) or marketplaces have on alcohol regulatory and compliance issues. They’ll need to continue confronting this rapidly evolving ecommerce environment in 2022.

THREE TIERS AND A TPP

A key challenge for regulators will be figuring out how to fit unlicensed TPPs into beverage alcohol’s three-tiered system. They’ll also need to determine how these business models intersect with marketplace facilitator laws.

Currently, some businesses that solicit sales and deliver alcohol to consumers on behalf of licensed retailers are licensed entities. However, if a license isn’t required by law, some may be unlicensed.

In most jurisdictions, the licensed seller (e.g., the wine ship or liquor store) must maintain control over all aspects of the sale, including 100% of the funds. Yet this is at odds with most state marketplace facilitator laws, which require marketplace facilitators to remit all applicable taxes to the appropriate taxing authority.
The California Department of Alcoholic Beverage Control (ABC) main principles on unlicensed third-party service providers:

- **PRINCIPLE 1**
  Only licensees may engage in activities that require an alcoholic beverage license.

- **PRINCIPLE 2**
  Licensees are ultimately responsible for the actions of third parties hired to conduct any activities involving the sale or marketing of alcohol on their behalf.

- **PRINCIPLE 3**
  The flow of funds must be controlled by the licensee and third parties should not share in the profits, but may receive service fees.

- **PRINCIPLE 4**
  Unlicensed third parties cannot take title to alcoholic beverages. The licensee must retain control over the storage and fulfillment of alcohol to consumers.

**Source:** Hinman & Carmichael LLP

The California Department of Alcoholic Beverage Control has admitted that, “on its face,” the state’s marketplace facilitator law “appears to conflict with the Department’s position that only the licensee may be the ‘seller’ of the alcoholic beverages.” It “intends to make further inquiries” into the relationship between licensees and non-licensees, but for now, “licensees must receive all funds from the sale of alcoholic beverages and control all aspects of the financial relationship between them and any third parties acting on their behalf.” However, a registered marketplace may keep the sales tax and remit it as required by law.

Having the marketplace responsible for sales tax but the licensee responsible for excise tax can complicate reporting for all involved parties. Many states haven’t specified how the flow of funds should be handled, and those that have don’t all have the same requirements.
Ensuring alcohol isn’t delivered to minors is another key issue that will need to be addressed in 2022. Though delivery apps and TPPs deliver the alcohol, the licensee is responsible for verifying the legal drinking age of the consumer. Of course, the licensee faces challenges in doing so when they entrust a third party to make the physical delivery.

**California** has decided the licensee is responsible for keeping alcohol out of the hands of minors, even if alcohol is delivered by a TPP. That means the licensee is subject to discipline (e.g., fines, license suspension, or criminal prosecution) if a TPP delivers alcohol to a minor. Other states may reach different conclusions.

Another factor complicating regulation and compliance is the differing nature of the various TPP business models. For example, some companies merely facilitate orders for small retailers (e.g., convenience stores and package stores), who make the sale and deliver the alcohol in their own vehicles.
Others make the delivery on behalf of the retailer after facilitating the order. Some use common carriers to facilitate DTC shipments for wine retailers, while others are the actual licensees that own the inventory they sell—though they may seem like a TPP or marketplace to consumers.

Jeff Carroll believes additional regulation of TPPs is likely. “Marketplaces and delivery apps will continue the explosive growth we saw in 2020 and 2021, and alcohol agencies will continue to wrap their arms around the regulation and enforcement of these third parties. We’ll keep a close eye on whether jurisdictions choose to license and regulate these entities or whether they will take a lighter touch and focus solely on preventing underage delivery.”

To date, delivery apps and alcohol marketplaces have primarily acted as a facilitator rather than the retailer. But both business models are rapidly evolving in response to new opportunities and customer demand. In 2022 and beyond, states will look to step up their regulatory efforts to ensure all requirements are met.

**Figuring out fulfillment houses**

Another issue that will likely come to a head in 2022 pertains to fulfillment houses. Though the use of licensed fulfillment houses is widespread in the beverage alcohol industry, they’re becoming a hot topic in state legislatures.

Licensed fulfillment houses facilitate direct-to-consumer sales for thousands of wineries, many of which lack the space and resources to store and ship the wine they produce. Wineries contract with fulfillment houses to store wine, prepare it for shipment, and pass it to common carriers for
distribution to consumers throughout the country. These fulfillment houses can perform the same tasks for breweries, distilleries, even retailers.

Although critical for moving alcohol from producer to consumer, fulfillment houses aren’t considered the retailer of the alcohol they store and distribute so they’re not responsible for collecting and remitting the taxes due on those sales. That’s a job for the actual retailer (i.e., the producer or retailer).

The role of fulfillment houses is often misunderstood, as can happen with entities working behind the scenes. This puts them at risk of being shut out of the beverage alcohol industry, which would be catastrophic for producers reliant on them: Fulfillment houses have a hand in roughly 60% of shipments of wine in Tennessee, for example.

Indeed, Tennessee came close to banning the use of fulfillment houses in early 2021. Yet after discovering how banning fulfillment houses would actually affect the wine industry, Representative William Lamberth removed that language from the bill. Clarifying the role licensed fulfillment houses play could help prevent such close calls in the future. So could regulating them.

In 2021, fulfillment house bills were introduced in at least five states:

- Alabama
- Kansas
- Kentucky
- Ohio
- Tennessee

More states will likely follow their lead in 2022

Source: Alabama, Kansas, Kentucky, Ohio, and Tennessee
Will states cut off cocktails to go?

Even though many of the strictest restrictions triggered by the COVID-19 pandemic ended with the first wave in 2020, restaurants, bars, breweries, distilleries, and wineries in much of the country were unable to operate at full capacity well into 2021. Sympathetic to their struggles, numerous state and local governments authorized delivery and takeout sales of alcohol, including cocktails and single servings of beer, wine, and spirits. Consumers embraced these new options with gusto.

Limitations on in-person dining and the fact that many states now permit delivery apps and TPPs to deliver beer with burgers and margaritas with Mexican food caused use of food delivery services in the U.S. to more than double during the pandemic. Furthermore, food delivery has become a $150+ billion industry worldwide — triple what it was in 2017.

Relaxed restrictions represent an enormous change for businesses, states, and the country as a whole. And the change was solidified after temporary “cocktail-to-go” policies became permanent in many states, including Florida, Texas, and Wisconsin. Unwilling to go that far, California extended its temporary policy through 2026.
As welcome as this development was to many, other states might not make delivery and takeout sales of alcohol permanent in 2022. There’s increasing pressure from some parts of the beverage alcohol industry to allow these relaxed policies to expire, as New York and Pennsylvania have done. So long as businesses can function at full capacity no matter what future coronavirus variants throw at them, there’ll be less need to upset the long-standing status quo.

Still, states that recently expanded options for bars, breweries, distilleries, restaurants, and wineries are unlikely to walk them back: Once granted, it’s difficult to revoke expanded rights. So our fractured country may experience yet another divide: In these states you can order beer, cocktails, or wine with your takeout, in those states you can’t.
Other issues that could impact the beverage alcohol industry in 2022

The battle for market share between flavored malt beverages (FMBs) and ready-to-drink cocktails (RTDs) could intensify. The beer industry is watching with growing alarm as the spirits industry pushes for lower federal and state excise tax rates on RTDs.

The price of aluminum may continue to rise, increasing costs for the beer industry in particular.

The Biden administration’s Executive Order on Promoting Competition in the American Economy may impact the beverage alcohol industry. The Alcohol and Tobacco Tax and Trade Bureau (TTB) has been tasked with updating its trade practice regulations to rescind or revise regulations that “may unnecessarily inhibit competition” and reduce “barriers that impede market access for smaller and independent brewers, winemakers, and distilleries.”
The Supreme Court of the United States didn’t accept a case about a Florida retailer challenging Missouri’s alcohol delivery laws. What will that mean for wine retailers?

Ongoing strained supply chains could lead to increased rationing. In September, the Pennsylvania Liquor Control Board placed purchase limits on certain bottles for “the foreseeable future.” In North Carolina, consumers are simply encountering “out-of-stock” signs.

Supply chain troubles, shifting consumer habits, and innovative business models could lead to new regulations or policies for the beverage alcohol industry in 2022 and beyond.

We’ll track these changes, and more, at the Avalara Tax Desk.

### REASONS FOR THE LIQUOR SHORTAGES
1. Consumption has skyrocketed during the pandemic
2. Import costs have surged
3. There’s a shortage of truck drivers
4. There’s a shortage of glass bottles
5. It takes a long time to make many liquors

Source: NPR
Communications

The communications industry continues to ride waves of change and taxation upheaval as hope for the Federal Universal Service Fund (FUSF) reform surfaces, more communications services go to the cloud, and taxation of streaming services reaches a tipping point.

What the numbers tell us:

Source: Avalara Tax Desk

Source: Computer Weekly

Source: Grand View Research
What’s happening with the Federal Universal Service Fund?

The Federal Universal Service Fund (FUSF) helps subsidize unrestricted access to broadband, lifeline communications, and other public services for all U.S. citizens. Since its inception, the fund has been financed by telephone company revenues. Phone carriers pass these fees on to customers as part of their interstate and international service bills.

In July 2021, the Biden administration signed an executive order that opened up reclassification (from Title I back to Title II) for internet service providers (ISPs). This action sparked hope for some industry insiders that it may also ignite reform for the FUSF. That hope had been withering with the nomination delay of a fifth Federal Communications Commission (FCC) member; activity in late October may have revived it.

In April 2021, the FUSF contribution rate hit an all-time high of 33.4% – 20 years ago, it was in the single digits. Though the contribution factor dipped slightly to 29.1% for Q4 2021, it’s still dangerously high for sustainability.

Burgeoning broadband needs and a diminishing phone service revenue base have collided to push the fund toward the red. The fund’s only remedy at this point has been to raise its rates.

Then the current administration opened up net neutrality and other communications regulations for discussion in 2021, improving the possibility that authorities would also consider the fund’s imbalanced contribution sources. However, no real change is likely until ISP reclassification transpires ... and that is unlikely to happen until the administration nominates a fifth (FCC) member and releases the party deadlock.
commission was sitting with two Republican and two Democrat chairs and an empty tie-breaker seat.

Reports from late October 2021 stated the administration nominated Gigi Sohn – a net neutrality advocate – for one of the open seats and previous commissioner Jessica Rosenworcel as chairwoman. Recon Analytics founder Roger Entner speculated that net neutrality and program improvement for broadband accessibility programs would be top priorities.

Communications services consolidating into the cloud

Cloud-based services are like a smorgasbord of convenience and technology. You no longer need separate wires, towers, and accounts. Businesses can get data, voice, SMS, and videoconferencing all under one big silver cloud – and they’re doing it. Communications platform as a service (CPaaS) global market revenue hit $5.9 billion in 2020, and industry analysts estimate it will top $17.71 billion by 2024.

But where there’s convenience and consolidation, there also looms complexity – tax complexity. Communications tax is developing more gray areas as different forms of services and technologies converge at lightning speed. Businesses add and bundle new services, and their reach expands into new municipalities. All these tax jurisdictions – approximately 60,000 federal, state, and local – hold their own set of complicated taxation parameters and definitions for the multitude of services provided. Local tax directives can change frequently, challenging companies to stay aware and compliant. For example, West Virginia recently altered how it taxes streaming services. The state still exempts

“All these tax jurisdictions – approximately 60,000 federal, state, and local – hold their own set of complicated taxation parameters and definitions for the multitude of services provided.”
digital products from sales and use tax, but now they deem streaming services taxable.

As communications technology and availability continue to morph and evolve, so will their tax complexities.

Is streaming taxation at the tipping point?

Everybody’s doing it: cutting the cable cord. But as more people drop traditional cable services and sign up for streaming, local municipalities feel the cut to their revenue – and many are going after the streaming services for what they’re losing.

Several tax jurisdictions in Texas filed a class-action lawsuit against Hulu and Netflix in 2020. The suit proposed that under the Texas Utilities Code, the two companies must pay 5% of their gross revenues derived from their provision of video service in that municipality as a franchise fee for using the state’s utilities. The two streaming behemoths countered that they don’t hold a state-issued franchise authority certificate, and therefore the code doesn’t apply. The judge sided with Netflix and Hulu.

Other municipalities in states across the U.S. are taking up similar suits, and so far, three cases have met the same fate as the Texas locales. A California court determined that Netflix didn’t qualify as a “video service provider” under California’s Digital Infrastructure and Video Competition Act. Additionally, the judge felt the streaming video company doesn’t use an internet service provider in a way that warrants service fee liability.

Arkansas gave another win to streaming services when a district court ruled that the companies qualified for an exemption for services provided over the internet. A federal
court in Reno, Nevada, also shot down a case, barring the city from collecting a 5% tax on streaming services.

So far, the streaming services are prevailing. But how long will their luck last as their customer base continues to expand and tax jurisdictions’ cable coffers shrink? It’s doubtful local municipalities will give up their campaign to recoup revenue. Senior Tax Strategist at Avalara Toby Bargar said, “I suspect jurisdictions will not give up on taxing these services. At least a few will look at modifying or replacing their cable franchise fee ordinances altogether with something that has a more neutral public policy purpose able to withstand scrutiny.”

As of 2020, the global video streaming market share was $50.11 billion. Between 2021 and 2028, it’s anticipated to increase 21% annually.

What can we expect in 2022?

- The streaming landscape will mature into three dominant companies, and a large cast of extras as consolidation and proliferation take shape in 2022.
- The “cloudification” of communications will be a game changer in 2022.
- State taxing authorities will heavily scrutinize the relationship between marketplaces and digital service third-party sellers.
- A winning formula for state taxation of streaming may emerge in the coming year.
The tobacco and vape industry has had more clouds than sunshine lately: The FDA denied hundreds of vape product applications, a new federal tobacco tax proposal may suffocate smaller vape vendors and steer smokers back to cigarettes, and harsh new regulations imposed by the recent PACT Act revision are pushing electronic nicotine delivery systems (ENDS) vendors to automate tax calculations.

**What the numbers tell us:**

- **A proposed federal tobacco tax could elevate current state rates more than 50%**
  - **Current:** $50.33
  - **Proposed:** $100.66

  *Source: The Tax Foundation*

- **Chewing tobacco tax rates could skyrocket more than 2,034% under a proposed tobacco tax**
  - **Current:** $50.33 / lb
  - **Proposed:** $10.74 / lb

  *Source: The Tax Foundation*

- **Nearly 250 companies were issued marketing denial orders (MDOs) by the FDA in September 2021**

  *Source: CSP Magazine*

- **The FDA denied more than 1.1 million electronic nicotine delivery systems (ENDS) products in September 2021**

  *Source: FDA Center for Tobacco Products*
The downwind impacts of the PACT Act

Lawmakers passed the Prevent All Cigarette Trafficking (PACT) Act in 2009 to battle tax evasion and unlicensed sales of tobacco products, mandating interstate shippers to declare all cigarette sales to state tobacco tax authorities.

In December 2020, politicians quietly amended the PACT Act via the COVID-19 relief bill. As a result, the act also covers all electronic nicotine delivery systems (ENDS): electronic cigarettes, hookah pens, and vaping systems. Anyone who profits from advertising, selling, or transporting cigarettes and ENDS must comply with complex registrations, monthly reporting, and payment of all applicable taxes, including excise.

Though the act might curb crime, industry insiders also consider it capable of snuffing out the vaping sector – sending those seeking an arguably “healthier” alternative to cigarettes back to their traditional packs. How? Severely restrictive shipping and compliance requirements.

To comply with federal prohibition, FedEx and UPS no longer deliver ENDS products to private customers as of March and April 2021, respectively. The United States Postal Service (USPS), with limited exceptions, was forbidden to ship cigarettes directly to consumers with the original PACT Act.

Exceptions for ENDS may be granted if a vendor submits an application to the USPS Pricing and Classification Service Center. The catch? The applicant must be in absolute compliance with all state and federal regulations. Part of that compliance requires sellers to register with the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) and with every tobacco tax authority in every state they wish to operate – advertising included.
Tobacco and vaping vendors must also verify every customer’s age and identity, secure a point-of-purchase signature, and store all sales records for at least four years.

None of these parameters are entirely insurmountable, but they are expensive and time-consuming, particularly for smaller vendors who don’t have the resources. Slippery, ever-changing regulations challenge even the most thorough of sellers. And when you consider the repercussions for failing compliance – up to three years of jail time – for some vendors, it might not be worth the risk. An innocent oversight could end in incarceration. John Beaty, general manager of excise at Avalara, believes auditing activity will most likely increase, making noncompliance an even greater risk.

What will these new draconian regulations do to a once-burgeoning industry? If the vaping industry is even partially extinguished, the federal government will have essentially cut their excise tax revenue – and perhaps perpetuated the illicit activity they’ve intended to thwart.

VENDORS LIGHTING UP AUTOMATION OPTIONS FOR EXCISE COMPLIANCE

Most people who sell, ship, or advertise ENDS aren’t tax experts. But the recently amended PACT Act nearly requires them to be. In response to its harsh regulations and compliance parameters, many e-cigarette and vaping vendors are looking to automated solutions for help.

Without a uniform process, many (particularly small ecommerce vendors) find that total compliance with tobacco and vape excise tax is a challenging endeavor – one that’s never wholly accomplished as states and local municipalities constantly adjust change parameters and definitions. Sellers need help with the overload, and automated solutions can calculate excise tax and alert users when changes arise.
VAPE AND TOBACCO TAXES – HOW THEY DIFFER BUT MAY SOON ALIGN

A grand chasm for uniformity exists in excise tax policies for vape and tobacco throughout the country. How states calculate and what they calculate can vary widely. A vendor cannot assume Washington state taxes vape and tobacco products the way New York state does. For vape products, some states tax a percentage of the wholesale cost; some tax a percentage of the retail price; others tax per milliliter or whether the item is an open or closed system; a few like to mix it up and levy a combination, like Georgia.

State tobacco excise tax can diverge just as much as tax policies for vape products. Some states levy an excise tax on cigarettes then lump “other tobacco products” together for another rate. Other states, like Georgia again, charge separate rates for all three, even categorizing cigars as “little cigars” and “other cigars.” States can tax tobacco products 10 different ways and combinations thereof: cost price, gross receipts price, invoice price, manufacturer’s list price, manufacturer’s invoice price, manufacturer’s sales price, wholesale price, wholesale cost price, wholesale purchase price, wholesale sales price. Some states differentiate between moist and dry snuff and product units. Many states also impose sales tax on top of the excise tax.

The Biden administration has an idea to make taxes between cigarettes and vape more “even,” but it’s not necessarily beneficial for the industry or its customers. It’s proposing a federal tobacco tax that could more than double current cigarette tax rates in some states. The rates for chewing tobacco would skyrocket 2,034%, pipe tobacco 1,651%, and snuff more than 1,677% – dipping tobacco in Massachusetts would set a buyer back $20. The proposal would also inflict a federal tax on vapor products where currently none exists and align the tax rate with cigarettes.
Many experts speculate that matching vape products’ tax rates with those of cigarettes will do more harm than good, essentially taxing away any motivation smokers might have to switch from cigarettes to vape.

The tax may also invigorate black market activity. (We know how Prohibition worked out for alcohol.) Extreme taxation to the point where the average middle-class person can’t afford a product can work akin to a ban. And there’s the loss of tax revenue for all the products consumers aren’t purchasing.

**FDA DENIED PROFUSION OF APPLICATIONS FOR VAPE PRODUCTS**

The FDA is spending a good deal of time rolling out marketing denial orders (MDOs) for more than 1.1 million electronic nicotine delivery system (ENDS) products, asserting the flavored products don’t meet health standards (that cigarettes apparently do) and the enticing flavors attract teenagers to a greater degree (than regular cigarettes).

This from the FDA Director of Center for Tobacco Products, **Mitch Zeller**: “Companies who want to continue to market their flavored ENDS products must have robust and reliable evidence showing that their products’ potential benefit for adult smokers outweighs the significant known risk to youth. The burden is on the applicant to provide evidence to demonstrate that the marketing of their product meets the statutory standard of ‘appropriate for the protection of the public health.’ If this evidence is lacking or not sufficient, the FDA intends to issue a marketing denial order, which requires the product to be taken off or not introduced to market.”

The FDA mandated a September 9, 2020, deadline for all vape product application submissions. Except for menthol and tobacco, not one flavored vaping product ran the gauntlet. Many of those products have already been manufactured
and are in the market. Hundreds of companies were hit with denials, most small to midsize businesses. Three of the largest manufacturers are still waiting on determination.

Many small vape vendors fear they’ll go bankrupt should they comply with the FDA’s regulations. Some merchants are considering a synthetic nicotine replacement that would fall outside of the FDA’s current control. However, that option is expensive and perhaps not completely out of the agency’s reach.

Some consumer advocates and industry insiders fear the FDA is inching toward a total flavor ban. They’re also concerned tobacco smokers will stay with their old, less-healthy habits due to a lack of more appealing alternatives.

Also, should many of the smaller vendors fold due to these denials, a good portion of businesses and employees of an entire new industry could go bankrupt and face unemployment. And there’s the loss of local revenue that will come as well.

What can we expect in 2022?

- The total supply chain impact of the PACT Act will probably not yet come to fruition
- We’ll likely see the effects of M&A activity
- An increase in electronic filing enforcement and changes toward uniformity standards may be coming
Energy

Congress passed the massive infrastructure bill in the middle of November 2021 with hopes of fortifying our nation’s roads, internet service access, and power grid, but what else will it usher in? Resurrection of the Superfund is on that list for certain. The nation’s leaders are also continuing to seek solutions for the diminishing Highway Trust Fund.

What the numbers tell us:

- **Roughly 70% of hazardous waste sites have been identified and the perpetrators assessed for cleanup**

- **$9.74 per ton**
  - The Superfund could impose taxes as high as $9.74 per ton on certain chemicals

- **96K+**
  - Electric vehicle charging ports exist in the U.S. as of December 2020

- **The federal Highway Trust Fund receives 84% of its income from the federal motor fuel excise tax**
The 2021 infrastructure bill

More people using the power grids, more vehicles on the roadways, more people fueling their cars, heating their homes, using water systems, airports, public transportation, etc. We need more resources to fortify and expand our infrastructures. But how do we do that? Federal and local governments have been puzzling over this question for decades.

The massive $1.2 trillion spending package is the Biden administration’s answer to our country’s infrastructure woes, passing with a 228-206 final vote in the second week of November 2021.

The bill proposes to fund new and upgraded infrastructure, such as highways, roads, bridges, waterways, ports, mass transit, broadband, power grids, and the “largest investment in passenger rail since the creation of Amtrak.” The price tag also includes promoting the proliferation of electric vehicles (including school buses) and charging ports as well as environmental remediation, particularly for Superfund hazardous waste sites.

Also buried among its 1,000+ pages are initiatives divergent from infrastructure, such as the broadest expansion of social services since the 1960s and a mandate for manufacturer-installed drunk driving censors (advanced impaired driving technology) in all new passenger vehicles (bill page 403) by 2024.

According to the White House, the bill will create 1.5 million jobs per year for the next 10 years. But others are worried about the package’s cost and negative impact on several industries, particularly small businesses in the coal, oil, and
gas sector. According to the Congressional Budget Office (CBO), the bill will add $256 billion to the country’s deficit.

**RETURN OF THE SUPERFUND**

The Superfund may return ... and it may not be super popular. A hazardous waste excise tax targeting the oil, gas, and chemical industries, the Carter administration enacted the Comprehensive Environmental Response, Compensation, and Liability Act in 1980 to offset the exorbitant costs of remediating contaminated sites. Congress renewed the tax under Reagan but let it lapse in 1995. Now the Biden administration has resurrected the fund to help subsidize spending for the infrastructure bill.

Since the Superfund’s expiration, the EPA has been dipping into Treasury (i.e., taxpayers’ pockets) funds for cleanup. According to John Beaty, general manager for excise at Avalara, 44,000 cleanup sites exist, 1,300 sit on the national priority list.

So, what’s the issue with the return of the Superfund? It severely hindered many gas and oil companies and could very well do so again. Industry leaders say a revival will not only affect legitimate offenders but also hinder the entire industry – partly because the tax will be levied on importing the chemicals, not just their production.

On the tax’s roster are 42 chemicals – 10 are top players for the oil and gas sectors. If reinstated, it would double the rates imposed from 1995, and chemical sales would be hit with a tax rate range between 44 cents and $9.74 per ton.
Those additional taxes will undoubtedly be imposed on consumers through increased prices for goods and fuel. One of the chemicals with the highest tax, benzene, is used to produce a vast spectrum of products, such as plastics, dyes, spray paint, detergents, and drugs. Potassium hydroxide is another chemical on the list used to make soap, alkaline batteries, fabric, and wart treatments, and to diagnose fungal infections. So, the tax could hit home for consumers.

Superfund resurrection has had support on both sides of the aisle. Let’s see how that support plays out in the coming years. Though the democrats claim plenty of measures exist to pay for it, the CBO score suggests it will dump $350 billion onto the country’s deficit.

**FUELING THE HIGHWAY TRUST FUND**

Diminished highway traffic in 2020 collided with the increase of high-fuel efficiency cars and elevated electric vehicle (EV) registrations to put a dent in the federal Highway Trust Fund. The fund that supports federal transportation infrastructure expenditures receives roughly 84% of its revenue from the federal motor fuel excise tax. Fewer gasoline-powered vehicles on the roads – whatever the reason – means less gas is being purchased, and less excise tax is collected, and thus the highway fund deflates.
And because most states also impose taxes on motor fuels, the drop dings state tax revenues.

The most direct and obvious solution is to raise the tax rate – many states have done this, but the federal government hasn’t since 1993. But a bump in fuel tax rates could knock down business income and payroll tax receipts.

In response, federal and local governments are seeking other resource avenues. One option that’s already gained momentum at the state level is a tax on electric car charging station purchases and usage. As of December 2020, there are 30,451 locations nationwide that host 96,536 public charging ports.

Many supporters see a charging port tax as a natural progression: Why shouldn’t EV owners contribute to the maintenance fund when they use the very same roadways as traditional automobiles owners? As of September 2021, 35 states and the District of Columbia charge some variety of charging station tax, and as of October 2021, 30 states have imposed additional fees for EV registrations.

Still, others caution that even though EV registrations shot up 41% in 2020, the charging station tax wouldn’t suffice to fill the tax gap.
Other options being floated around are an excise tax on electricity and a mileage tax. An excise on electricity would tax everyone, even those who don’t drive or commute very little. And a mileage tax bears a host of concerns. Privacy sits at the top of the list as a government-powered GPS tracking system is an obvious method to calculate and record user mileage.

A mileage tax could also present equity issues – lower-income households would feel the most impact. Would a previously affordable long work commute become unaffordable for some? Many families who can’t afford to fly to see relatives or enjoy vacations often opt to take to the road, but a mileage tax may make even a modest getaway out of financial reach.

Oregon and Utah have already established test programs, and at least a dozen other states are eyeing the option.

One workaround to the personal privacy concern lawmakers are considering is a mileage tax for commercial vehicles only. This modification would bypass many concerns and implementation obstacles.

Regardless of the solutions, there seems to be little doubt that if the federal Highway Trust Fund remains on its current trajectory, the fund would be $189 billion in the red by 2030.

What can we expect in 2022?

- FURTHER DEBATE ON HOW TO FUND THE HIGHWAY TRUST FUND
- POSSIBLY MORE STATES TAXING ASPECTS OF ELECTRIC VEHICLE PURCHASES OR USES
- HIGHER TAXES TO SUPPORT THE INFRASTRUCTURE BILL

If a 5-cent tax per mile traveled by trucks had been in place in 2017, it would have generated between $4 billion and $13 billion in revenues that year, depending on the types of trucks and roads that the tax applied to.

Source: Congressional Budget Office
Looking ahead

Though the pandemic has forced us to physically distance, it’s also revealed how interdependent we are. More than ever, what transpires on one side of the world affects what happens on the other. A closed factory in Vietnam leads to a logjam at ports in Los Angeles; successful tax policies in Brazil influence tax policy in Italy. And so on.

This report aims to help businesses striving to succeed in this interconnected environment stay nimble and well informed. While we can’t explore everything, we’ve captured the major changes likely to shape business and tax compliance in 2022. If you want more, check out our other resources:

• Stop by the Avalara Tax Desk for breaking tax news
• Read about VAT in the EU and U.K.
• Check out the Avalara tax resource center
• Go to the Avalara Commerce Monitor for transaction-data trends across the manufacturing, retail, and services industries

Or give us a call at 877-352-4646. Automating tax compliance helps businesses track and comply with ever-changing tax laws around the world.