TAX CHANGES

Avalara

2024

A TAX COMPLIANCE GUIDE FOR BUSINESSES

Contents

As in past years, Avalara Tax Changes covers many of the key issues affecting tax compliance for businesses: the rise in artificial intelligence, omnichannel commerce, e-invoicing, retail delivery fees, to name a few. We invite you to get comfortable and settle in for a good read.

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

Whatever else you may say about the past year, it certainly hasn't been dull. ChatGPT. Spy balloons. Bank failures. Strikes. There's no knowing what we'll wake up to on any given day.

The worst of the COVID-19 pandemic may be behind us, but another pandemic is likely. The U.S. economy exceeded expectations, but a recession still seems inevitable. The federal government narrowly averted shutting down in September and November 2023, but the stopgap funding extensions are set to expire in early 2024.

If global growth was more resilient than anticipated in 2023, the outlook for the medium term is subdued. Inflation in core areas is proving sticky. Geopolitical unrest near and far has many people on edge.

In short, these are uncertain times.

Whether dealing with surpluses or deficits, contraction or growth, governments often respond to new and changing circumstances with new and changing tax policies. That makes compliance tricky for businesses dealing with new and changing circumstances of their own.

To give businesses a leg up, the tax experts at Avalara have come together to explore emerging tax and compliance trends in:

We can't address everything, of course. The world is too big, tax too complex, and attention spans too short. But our eighth annual tax changes report will give you an overview of some of today's key issues and what to look out for tomorrow.

Let's do this.

Sales tax

A growing dependence on sales tax revenue plus a shrinking sales tax base could inspire states to refine their sales tax laws in 2024. While waiting to see what states do, taxpayers have plenty to deal with: New retail delivery fees, product taxability and tax rate changes, and confusing simplification measures in home-rule states are just some of what's affecting sales tax in 2024.

SALES TAX

Income tax is out. Retail sales tax is in.

That's just one of the trends likely to affect sales tax in 2024.

State budgets will grow increasingly dependent on sales tax revenue in 2024 and beyond, as almost 30 states have lowered corporate or personal income tax rates since the start of 2021. But "states wishing to transition from income toward consumption taxation will eventually need to reckon with long-standing issues facing the sustainability of state sales taxes," according to the **National Conference of State Legislatures**.

Though **sales tax is the second-largest source of state tax revenue**, evolving consumer and technology trends are eroding the sales tax base. Many sales tax laws are woefully outdated.

For instance, most states don't tax the majority of services even though services now account for approximately 70% of all personal consumption. Per the National Conference of State Legislatures, Hawaii, New Mexico, and South Dakota are the only states where a significant majority of 176 specified services are subject to sales tax.

Moreover, despite the rise of digital goods and streamed content, and the corresponding demise of the CD, DVD, and floppy disk, about half of all states still don't tax digital products or streaming services.

This is a byproduct of changing technology. States haven't changed *what* they tax; they still tax what's sold on a CD, DVD, or floppy disk. What's changed is that very little is delivered by CD, DVD, or floppy disk today.

"The taxation of streaming services has long been complicated by advancements in technology as well," says Scott Peterson, VP of Government Relations at Avalara. "Long ago, cable television began to compete against broadcast television. TV watchers didn't pay to receive broadcast television so there wasn't anything to tax. Cable television was different because there was a charge. It didn't take governments long to start taxing cable television."

Many states are further weakening their sales tax base by establishing new sales tax exemptions – either permanent or temporary – for a range of consumer goods. Yet most states continue to tax many business inputs (which economists argue should be exempt).

Should certain taxable transactions be exempt? Should sales tax apply to currently exempt transactions? Are there any new and creative ways to obtain more tax revenue from retail sales? As 2024 unfolds, expect states to grapple with these questions – and more.

WHAT THE NUMBERS TELL US

Sales tax

ECONOMIC GROWTH

Real (inflation-adjusted) gross domestic product could increase by 1.5% in 2024

0.9% IN 2023

1.5% IN 2024

2.4% IN 2025

SOURCE: CBO

SOURCE: CBO

INFLATION CONTINUES TO GRADUALLY DECLINE

Growth in the price index for personal consumption may continue to slow down

3.3% IN 2023

2.6% IN 2024

2.2% IN 2025

STATE RAINY DAY FUNDS REACHED AN ALL-TIME HIGH

$164B

in fiscal year 2022

SOURCE: Tax Policy Center

CHALLENGES HIRING QUALIFIED EMPLOYEES

47%

of CEOs surveyed in September 2023 were struggling to find talent for key positions

SOURCE: The Conference Board

RETURN-TO-OFFICE POLICIES

90%

of companies surveyed plan to implement RTO policies by the end of 2024

SOURCE: Resume Builder

SALES TAX

Economic uncertainty hasn't settled

To put the state of sales tax into perspective, it helps to start with a broader view of economic trends.

ECONOMISTS PREDICT PERSISTENT INFLATION, FRAGILE GROWTH

The **International Monetary Fund** (IMF) expects global growth to hold steady at 3% in both 2023 and 2024. That's slightly more optimistic than the Organisation for Economic Co-operation and Development (**OECD**), which projects 2023's 3% global growth rate to slow to 2.7% in 2024.

The OECD take on the American economy is more dismal still: It predicts U.S. gross domestic product (GDP) growth to slow from 2.2% in 2023 to 1.3% in 2024. More upbeat, the **Congressional Budget Office** (CBO) is forecasting sustained economic growth for 2023 to 2025 – though it expects "a soft patch in the near term."

STATE BUDGETS ARE "READY AND WAITING FOR A SLOWER ECONOMY"

About half of all states expect **state tax revenues** to slow in fiscal year 2024. Analysis of monthly tax collection reports shows at least **17 states** experienced year-over-year declines for the 12 months ending June 30, 2023.

Fortunately, state rainy day funds reached an all-time high of **$164 billion** in fiscal year 2022. This "revenue cushion" should help states withstand a recession, should one come, even given increased spending on education, health care, and other needs. Indeed, **Fitch Ratings** reports "U.S. state budgets are ready and waiting for a slower economy in the coming months." And, according to Bloomberg Tax Research, sales tax revenue for August increased 1% year over year in 28 states, to **$29.9 billion**.

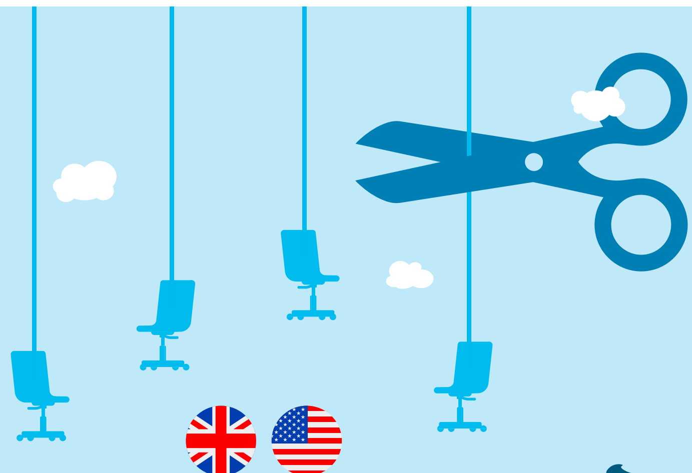
Notably, taxable sales and purchases for April, May, and June of 2023 were **up 16.8%** in North Dakota; sales tax revenue in **New York City** grew 5.2% year over year during the fourth quarter of the fiscal year (April 2023 to June 2023). The positive trend extended to Texas, where Comptroller Glenn Hegar sent cities, counties, transit systems, and special purpose districts **$1.1 billion** in local sales tax allocations for October 2023, 4.5% more than in October 2022.

BUSINESSES ARE PREPARING FOR RECESSION

What do businesses think? Well, 72% of CEOs surveyed by **The Conference Board** in late September 2023 reported that they are preparing for a U.S. recession over the next 12–18 months. Of those, 69% expect "a brief and shallow recession." An **August 2023 survey** of CFOs in the U.K. and U.S. garnered somewhat similar results: Over half of the polled CFOs are anticipating a recession and operating in cutback mode (using consumer spending, Consumer Price Index, and Producer Price Index as indicators of a recession).

Since business must go on, recession or no, companies need people and/or technological tools to get jobs done. Unfortunately, like last year and the year before, many businesses are finding it hard to fill positions.

WHAT DO BUSINESSES THINK?



72%

of CEOs surveyed by The Conference Board in September 2023 reported that they are preparing for a U.S. recession **over the next 12-18 months**

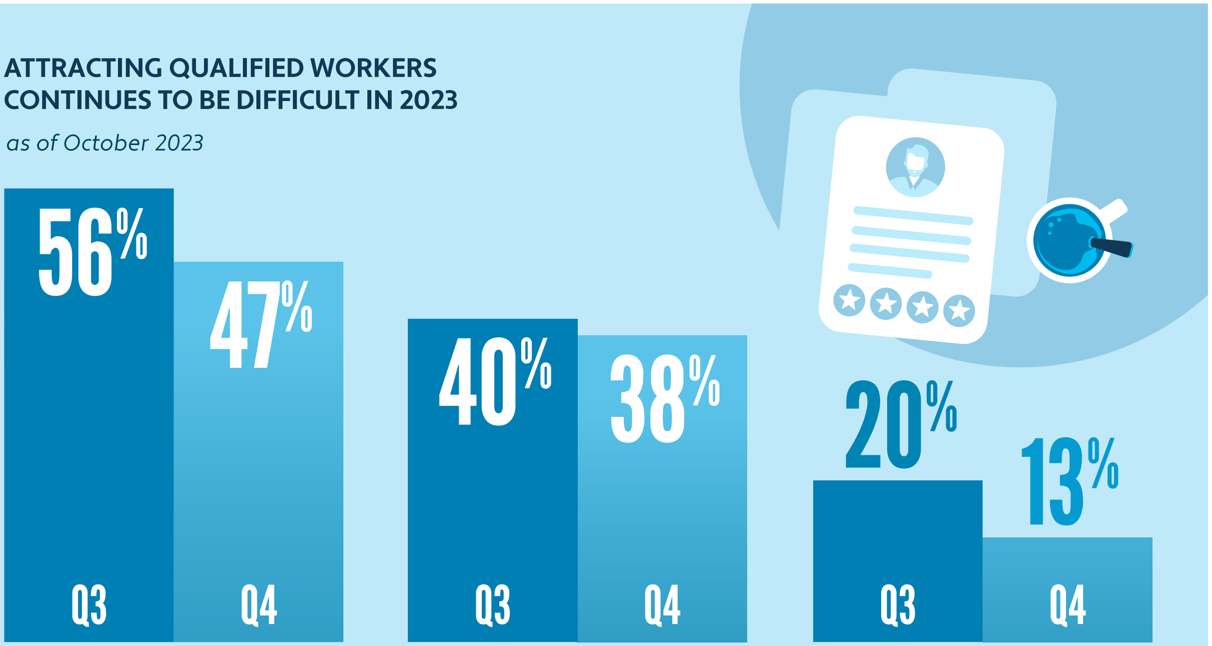
SOURCE: *The Conference Board*

A 2023 survey of CFOs in the U.K. and U.S. garnered somewhat similar results: **Over half of the polled CFOs are anticipating a recession and operating in cutback mode**

SOURCE: *Avalara/Censuswide survey*

ATTRACTING QUALIFIED WORKERS CONTINUES TO BE DIFFICULT IN 2023

as of October 2023



CEOs reporting **some problems** attracting qualified workers

CEOs expect to **expand their workforce** over the next 12 months

CEOs expect a **reduction** in their workforce over the next 12 months

SOURCE: *The Conference Board*

EMPLOYERS STILL NEED TALENT

Attracting qualified workers continues to be difficult for many companies surveyed by **The Conference Board**, but the situation seems to be improving: 47% of CEOs surveyed in late September 2023 reported problems attracting qualified workers, down from 56% in Q3.

Of **CFOs surveyed in August 2023** (who could select more than one response):

- 81% reported a talent shortage in accounting
- 49% were experiencing a talent shortage in Financial Planning and Analysis (FP&A)
- 42% reported a talent shortage in Accounts Receivable (AR)
- 39% reported a talent shortage in Accounts Payable (AP)

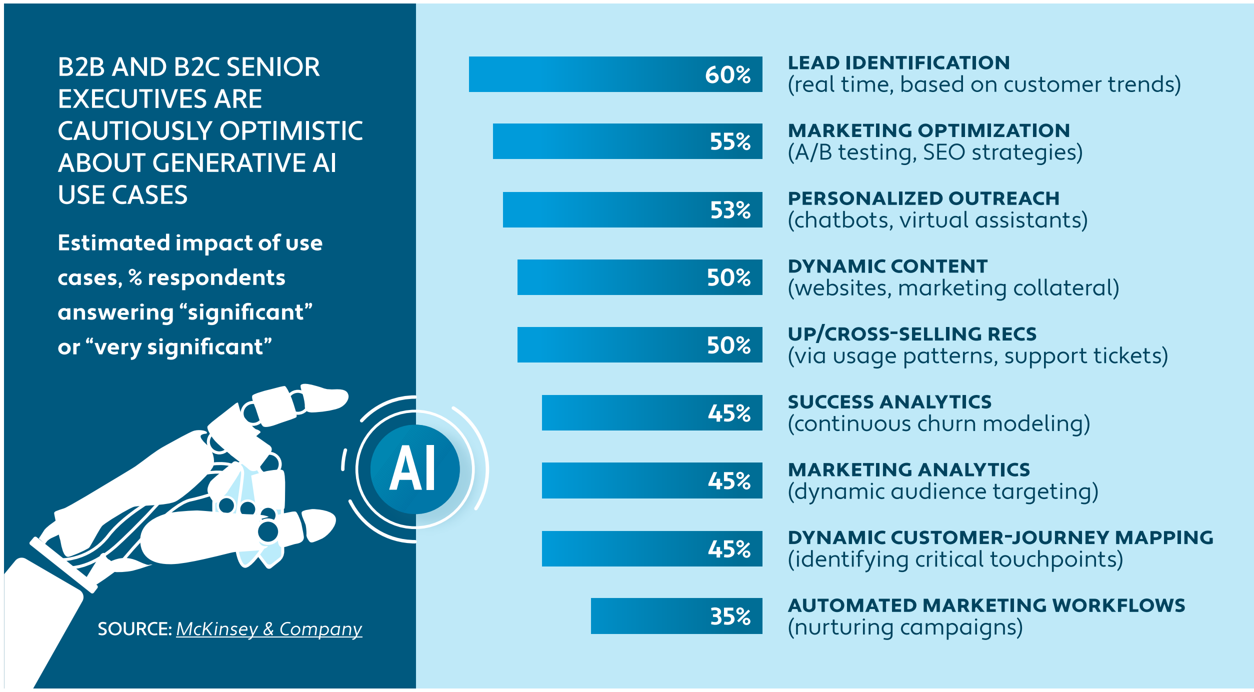
Increasing wages can help attract and retain employees – 71% of the CEOs surveyed by The Conference Board plan to raise wages by more than 3% over the next year. But given the fierce competition for talent, some businesses are considering alternative options. Like artificial intelligence (AI).

AI'S GOT TALENT

Just over 92% of the CFOs surveyed in the U.S. and U.K. agree AI tools will help drive efficiency, productivity, and profitability for their businesses. And about 96% of the CFOs said they plan to adopt AI within their finance teams in the next 11 months.

Artificial intelligence hasn't just caught the eye of the finance sector. The release of ChatGPT in November 2022 propelled AI into **manufacturing**, **marketing and sales**, **medicine**, **supply chain management**, and even **tax compliance**. There are seemingly endless possibilities for AI tools. They may even help bring byzantine government systems into the modern age.

The **IRS** is using AI to help uncover tax evasion. The agency is relying on artificial intelligence and improved technology to help examine 75 of the nation's largest partnerships and to identify "sophisticated schemes to avoid taxes." AI will help IRS compliance teams "identify emerging compliance threats and improve case selection tools to avoid burdening taxpayers with needless … audits."



Artificial intelligence can help tax officials improve compliance in other ways as well. For example, **Colorado** and **Missouri** are leveraging AI-driven Avalara Tax Research for Government to power their publicly available sales and use tax information hubs. The technology facilitates communication between state regulators and enables the states to easily keep track of ordinances, rules, taxability information, and proposed tax changes within their local jurisdictions.

Jayme Fishman, EVP and GM of Indirect Tax at Avalara, explains: “Using the best in artificial intelligence, automation, and a team of tax experts, Avalara’s solutions and database for tax compliance rates and rules help increase the accuracy and timely validation of tax data for businesses and governments alike.”

It’s a big job, because state sales tax laws are continually in flux.

SALES TAX

The state of state sales tax

There was a good deal of **state tax reform** in 2023, for the third consecutive year, and that trend is looking to continue into 2024. With respect to sales tax, states are primarily focusing on a few key areas:

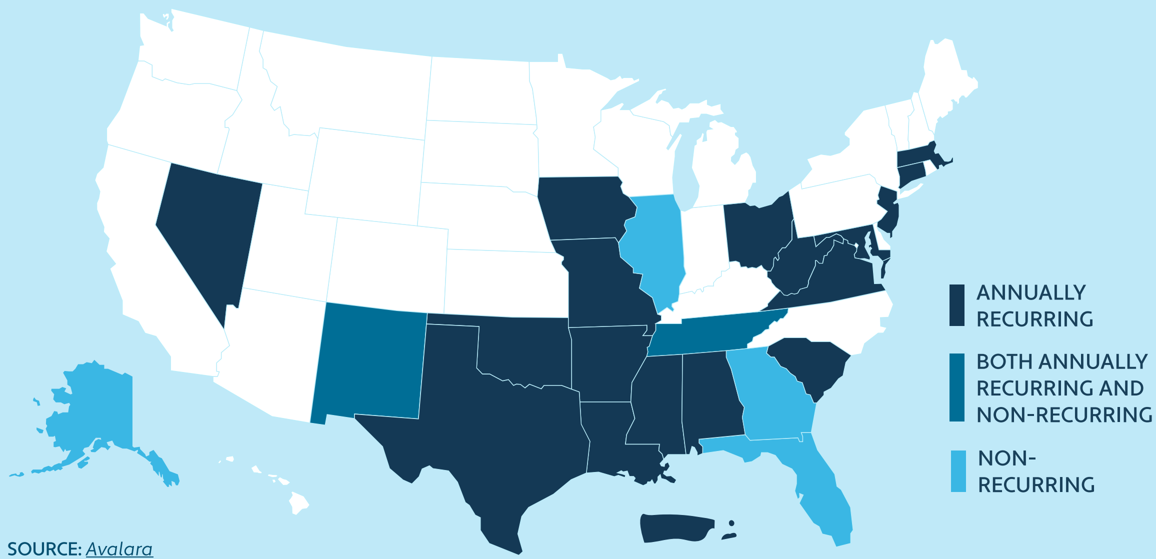
- Economic nexus
- Marketplace facilitator laws
- Retail delivery fees
- Sales tax holidays
- Taxability changes

TRIMMING THE FAT FROM ECONOMIC NEXUS LAWS

The United States Supreme Court decision in **South Dakota v. Wayfair, Inc. celebrated its fifth anniversary** on June 21, 2023, six months after the last **holdout state began enforcing an economic nexus law** the Wayfair ruling freed it to enact. The anniversary marked the end of a fast-paced period of rapid change that set businesses scrambling to be sales tax compliant.

STATES IN 2023 WITH SALES TAX HOLIDAYS

Alabama, Alaska, Arkansas, Connecticut, Florida, Georgia, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas, Virginia, and West Virginia



SOURCE: *Avalara*

States fell over themselves to adopt economic nexus in the wake of the Wayfair decision, and perhaps with good reason: Had Wayfair been successfully challenged, states could have lost the right to tax remote sales before they had the chance to benefit from the ruling.

To minimize the likelihood of a legal challenge, most states followed South Dakota's lead and set an economic nexus threshold of $100,000 in sales or 200 transactions in the state in the current or previous calendar year. But it didn't take long for some states to reconsider those thresholds.

California was one of the first states to realize South Dakota's threshold may not be the best fit, especially for a state with one of the world's largest economies. As of October 1, 2023, roughly **20 states had adjusted their economic nexus thresholds** in some way, and **10 states had dropped the transaction threshold** – including economic nexus pioneer South Dakota.

A **transaction threshold is still in effect in 25 states**, but that will likely change in 2024. Minnesota and Utah are gearing up to introduce legislation to this effect, having missed the opportunity during their 2023 legislative sessions. Other states will almost certainly do the same.

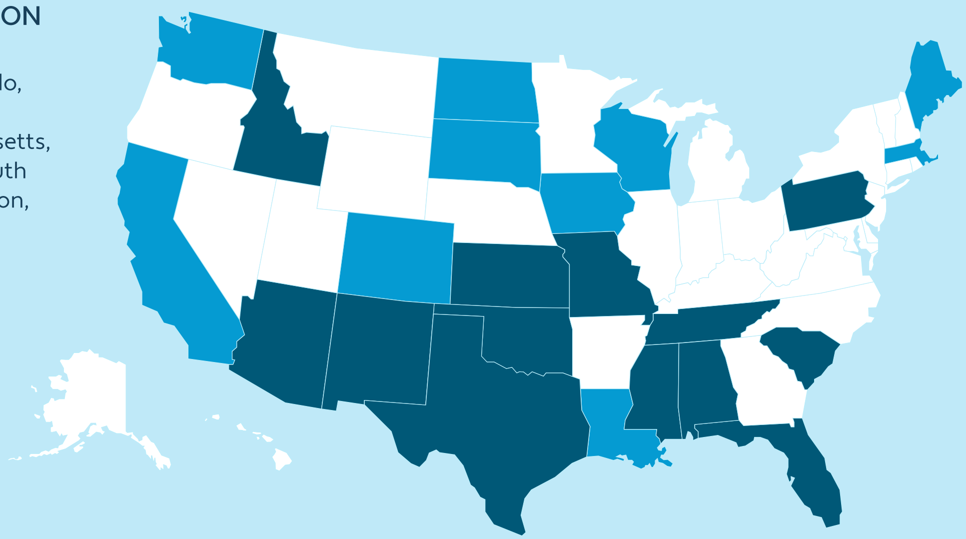
Moreover, the **Streamlined Sales and Use Tax Governing Board** (SSTGB, or simply SST), an organization dedicated to streamlining and reducing the cost of sales tax compliance for businesses, is encouraging states to **get rid of their transaction thresholds**. "The SST states are the majority of states that have a transaction threshold," observes Scott Peterson, VP of Government Relations at Avalara and former Executive Director of SST. "If they get rid of it then very few states will have it."

Peterson adds that for businesses as well as states, the amount of tax collected should be greater than the cost of compliance. "Since the Wayfair decision, states have realized there are businesses that sell a lot of very inexpensive products, producing an amount of tax that is much less than the cost of compliance." This is the incentive behind eliminating the transaction threshold.

SST is also looking to **establish a best practice** for how quickly a state should require a remote business to register for sales tax after crossing an economic nexus threshold. At least eight states plus Puerto Rico and the District of Columbia currently require businesses to register as soon **as they cross the economic nexus threshold**.

STATES THAT CUT TRANSACTION THRESHOLDS

California, Colorado, Iowa, Louisiana, Maine, Massachusetts, North Dakota, South Dakota, Washington, and Wisconsin



STATES WITH NO TRANSACTION THRESHOLD FROM THE OUTSET

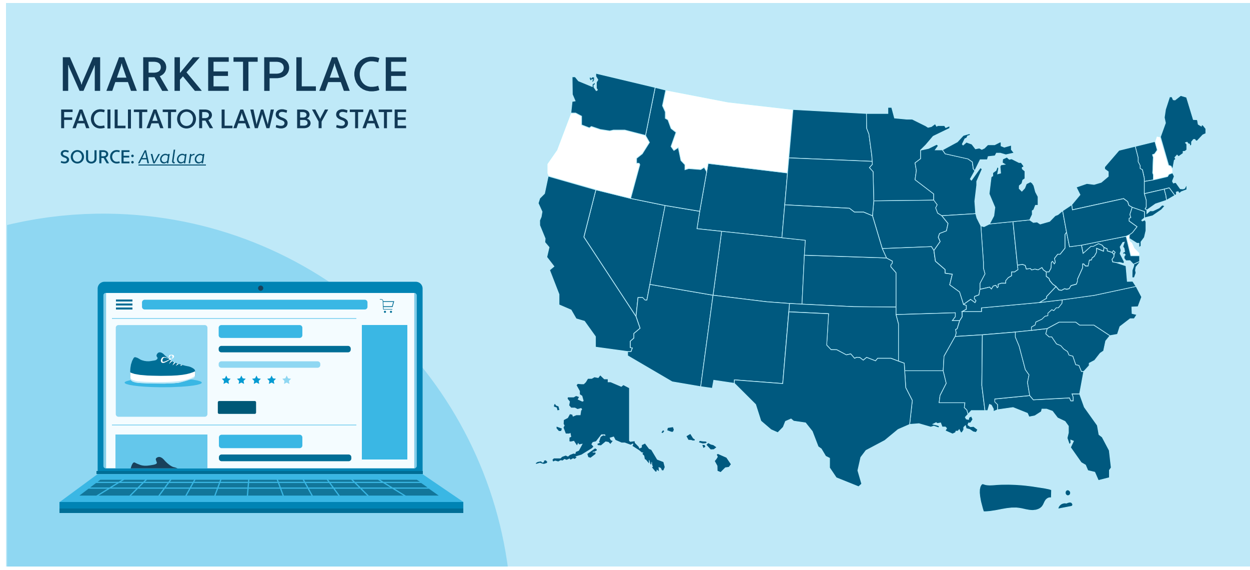
Alabama, Arizona, Florida, Idaho, Kansas, Mississippi, Missouri, New Mexico, Oklahoma, Pennsylvania, South Carolina, Tennessee, and Texas

SOURCE: *Avalara*

That bears repeating: In some states, if you make a sale that puts you over the economic nexus threshold, you're required to register and start collecting sales tax *before the very next sale*.

The **Government Accountability Office** lists registration timing as part of "a complex patchwork of requirements" in the taxation of remote sales, so it's little wonder SST recommends states give businesses **60 days to register** after they cross a state's economic nexus threshold.

Of course, economic nexus is just one part of the remote sales tax equation. Marketplace facilitator laws are another.



RESHAPING MARKETPLACE FACILITATOR LAWS

Every state's economic nexus law provides an exception for small sellers whose sales don't meet the state's registration threshold. Many of those small businesses sell through marketplace platforms that help them reach a broad market. So, states created marketplace facilitator laws that enable them to capture revenue from those marketplace sales without unduly burdening the marketplace sellers. (At least this is how states view marketplace facilitator laws today; the **marketplace facilitator laws origin story** is much longer.)

Marketplace facilitator laws make the marketplace platform responsible for collecting and remitting the tax due on all sales made through the platform – their own (direct) sales *and* marketplace (third-party) sales. That's true for all states, but beyond that, marketplace facilitator laws can vary considerably from state to state.

As with economic nexus laws, many states adopted marketplace facilitator laws quickly in order to increase sales tax collections from marketplace sales. And as with economic nexus laws, many states are in the process of refining their marketplace facilitator laws. Pressing issues for states include:

- Defining what type of business is, and isn't, a marketplace
- Establishing which taxes marketplaces facilitators are responsible for
- Understanding what marketplaces do in the metaverse

Pressing issues for marketplaces, and by extension marketplace sellers, include:

- Adhering to new consumer protection mandates (**the INFORM Consumers Act**)
- Complying with new 1099 reporting requirements
- Managing exempt sales (and exemption certificates)

We cover marketplace facilitator laws more in the **retail**, **beverage alcohol**, **lodging**, **manufacturing**, and **software** sections of this report.

RETAIL DELIVERY FEES: A MASQUERADING TAX

Colorado rocked retailers in 2022 by implementing a revolutionary **retail delivery fee** of 27 cents on all deliveries in the state that 1) are made by motor vehicle and 2) contain at least one item of taxable tangible personal property. Though inspired by the high volume of online sales, the sales-tax-masquerading-as-a-fee affects a wide range of businesses including brick-and-mortar retailers, florists, and restaurants. The fee took effect July 1, 2022, and jumped to **28 cents** on July 1, 2023.

States like to watch and learn from each other, so within a year, **Minnesota enacted a retail delivery fee** of its own. Minnesota's version of a retail delivery fee, which is similar but different from Colorado's, will take effect July 1, 2024. The 50-cent fee will apply to most retail sales of tangible personal property that are delivered in Minnesota, have a retail sale price of $100 or more, and are subject to Minnesota sales tax.

In a surprise twist, Minnesota's retail delivery fee also applies to the delivery of clothing, though clothing itself is generally exempt from sales tax in the North Star State. So that's confusing.

Other states will likely follow Colorado and Minnesota's lead. In fact, lawmakers introduced both **New York state and New York City retail delivery fees** in 2023. Though Colorado and Minnesota are the only states to enact retail delivery fees to date, there are compelling reasons for states to pursue them in the year ahead. For one, research suggests there will be **36% more delivery vehicles** in inner cities by 2030.

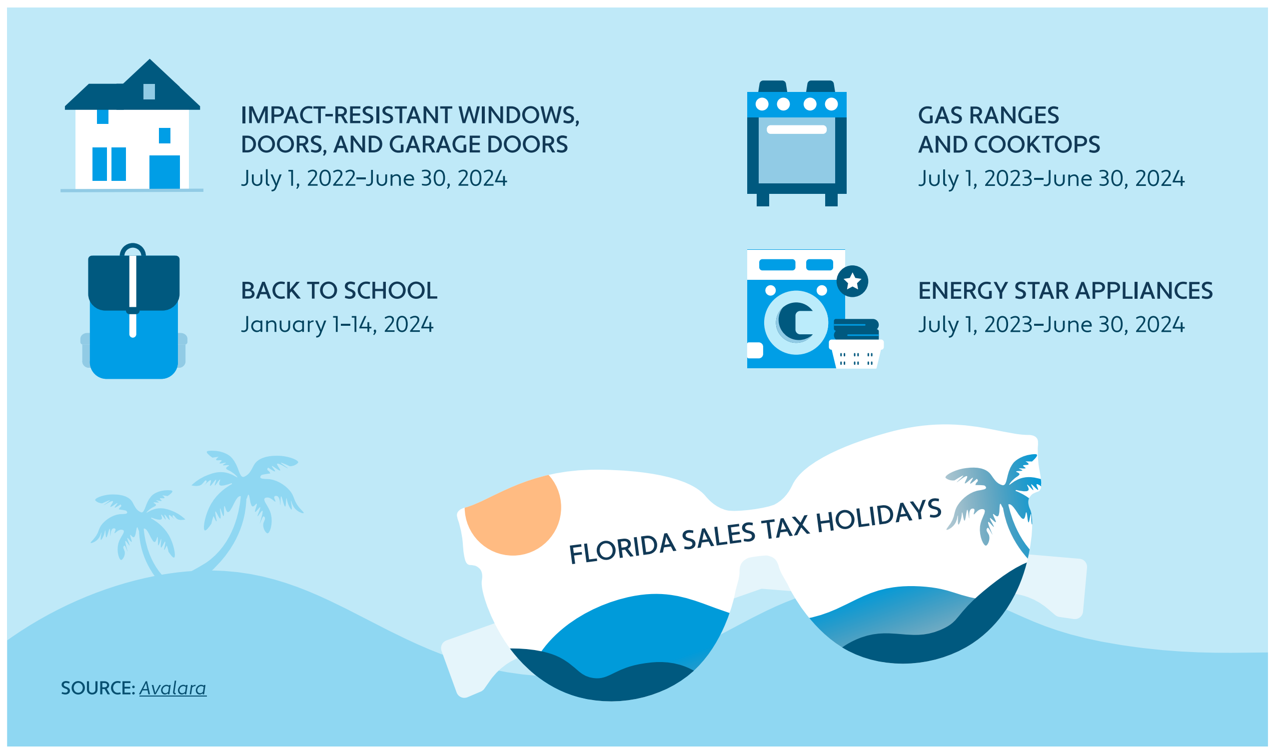
We cover retail delivery fees more in the **energy** and **retail sections**.

SALES TAX HOLIDAYS: BIGGER. LONGER. BETTER?

From a compliance perspective, sales tax holidays are another challenge for businesses these days. A number of states either created new sales tax holidays in 2023, or broadened or lengthened existing tax-free weekends.

Florida has **stretched sales tax holidays** to near breaking. A sales tax holiday is a temporary time away from sales tax. A vacation from sales tax, if you will. Vacations typically last a week or two, maybe three. Sometimes people take extended vacations. But when a vacation lasts months or even years, is it still just a holiday? Or is it something different – in this case, maybe simply a sales tax exemption?

We cover sales tax holidays in more depth in the **retail section**.



PRODUCT TAXABILITY CHANGES

Numerous states changed the taxability of everything from diapers and food to car seats and gun safes in 2023, and that trend will likely continue in 2024.

Most states are providing more sales tax exemptions: The few states that still tax groceries are moving toward exempting them, though at different paces; those that tax diapers and feminine hygiene products are doing the same.

For businesses that sell a variety of items into multiple jurisdictions, tracking taxability changes and implementing them into point-of-sale systems is busy work, but an essential task.

We cover taxability changes in more depth in the **retail section**.

STATE SALES TAX RATE CHANGES

Though statewide sales tax rates rarely change, we've seen a few in recent years. For example:

- The **Alabama state sales and use tax rate on food** went from 4% to 3% effective September 1, 2023. (Fun fact: Remote retailers that collect Alabama's flat 8% Simplified Sellers Use Tax on all sales in the state **do not benefit from the reduced rate**.)
- The New Mexico state gross receipts tax (GRT) rate dropped from **5.125% to 5%** on July 1, 2022, and from **5% to 4.875%** on July 1, 2023; a proposal to slash the rate further in 2024 was **vetoed** by the governor.
- The South Dakota state sales and use tax rate dropped from **4.5% to 4.2%** on July 1, 2023.

A proposed **seasonal sales tax rate** in Maine failed to gain traction during the 2023 legislative session, and the issue isn't likely to resurface in 2024. However, there's at least one more state sales tax rate change planned for the near future: The South Dakota state sales and use tax rate (including for food) is set to **return to 4.5%** effective July 1, 2027.

While state rate changes are few and far between, changes to local sales tax rates are commonplace.

SALES TAX

Buy local: The state of local sales tax

There are city and/or county sales and use taxes in 38 states, many of which have special district taxes as well (e.g., county ambulance districts, shopping districts, stadium districts). All told, there are more than 13,000 sales and use tax jurisdictions in the United States. Each has its own rate, and every rate is subject to change.

Local rate changes can affect out-of-state businesses as much as in-state businesses. Any business required to collect and remit sales tax in a state, whether based in the heart of the state or across the country, must collect and remit at the correct sales tax rate.

EVERY LOCAL RATE IS SUBJECT TO CHANGE

Recent and upcoming local rate changes include:

Maui County, Hawaii, has a new **0.5% county surcharge** in addition to the state general excise tax (GET) rate of 4%. The tax rate for transactions subject to the Maui County surcharge (CS), which is most transactions subject to the retail GET, is 4.5% starting January 1, 2024. The CS doesn't apply to wholesale transactions, which are subject to a 0.5% GET, or to insurance commission transactions, which are taxed at a rate of 0.15%. The surcharge should help **offset revenue losses** caused by the August 8, 2023, wildfires.

Beginning January 1, 2024, the city of **Milwaukee, Wisconsin**, is instituting a new 2% city sales tax to fund pensions, and the Milwaukee County sales and use tax rate increases from 0.5% to 0.9%. These tax rate changes could cause some confusion for businesses: Milwaukee is the only municipality to impose a city sales and use tax (though it affects Washington and Waukesha too), and Milwaukee County is the only county in the Badger State with a rate higher than 0.5%.

The Santa Cruz, California, Metropolitan Transit District may **raise the district transaction and use tax** above the existing 2% combined rate limit after January 1, 2024, provided 1) the board of directors of the district adopts an ordinance approving the tax increase before January 1, 2035; 2) the total additional tax doesn't exceed 0.5%; and 3) **Santa Cruz voters approve the tax hike**.

Tribal governments in New Mexico can **set their own GRT rates** as of July 1, 2023, "without regard to the rates in neighboring county areas." Additionally, Taos County can now impose a local option GRT of up to 0.5% to pay for hospital capital costs and a nursing program, though the tax would need to be approved by county voters.

Three municipalities implemented a 1% **local option sales tax in Vermont** on July 1, 2023. With the addition of Rutland, Shelburne, and Stowe, there are 23 local option sales taxes in the Green Mountain State.

These and other local rate changes can be a headache for retailers, but the pain should be mild in states with centralized sales and use tax reporting. The migraine tends to accompany tax compliance in the country's few **home-rule states**.

LOCAL TAX RATE CHANGES

2%

THE CITY OF MILWAUKEE
is the only municipality in Wisconsin that imposes a city sales and use tax

IN MILWAUKEE COUNTY,
the sales and use tax rate will increase from 0.5% to 0.9%

SOURCE: *State of Wisconsin*

SIMPLIFYING HOME-RULE TAX REQUIREMENTS

When it comes to sales tax, “home rule” means local governments have the authority to levy and administer their own local sales tax rates and rules. This tends to make sales tax compliance extremely challenging, especially for businesses required to collect and remit sales taxes in numerous jurisdictions. Thus, all home-rule states are working to reduce the burden of compliance for businesses.

Arizona took great strides toward **simplifying transaction privilege tax compliance** back in **2021**. The Grand Canyon State sought to further **reduce compliance complexity in 2023** in several ways, including by allowing remote sellers to collect and remit a single municipal tax rate rather than the various rates in effect across the state. Unfortunately, for remote sellers, the bill did not make it into law.

Alabama, Louisiana, and Colorado have also all taken steps toward sales tax simplification, but they still have a long row to hoe.

ALABAMA CRACKS DOWN ON POLICE JURISDICTIONS

There are easily hundreds of local sales and use taxes in Alabama; the Alabama Department of Revenue administers some, local tax authorities administer others. This is par for the course in a home-rule state, but there’s an extra layer of complexity in Alabama because many municipalities have a police jurisdiction, and the tax rate in a police jurisdiction tends to be lower than the rate in effect in the rest of the city.

A law enacted in 2021 set a number of **new requirements** pertaining to annexations, deannexations, services, licenses, and taxes within a municipal police jurisdiction, in order to restrict the growth of police jurisdictions. Among other mandates, the law provides for the reporting and auditing of revenue collected within municipal police jurisdictions.

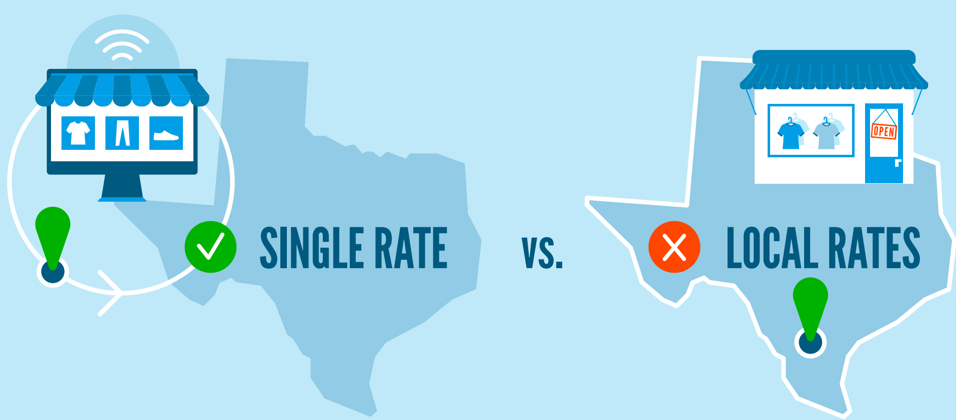
Any town or city that fails to comply with the new requirements must stop collecting taxes and fees in the police jurisdictions. Cities were given from March 2022 to March 2023 to comply with the new mandates and provide the necessary reports. Those that failed to fulfill all new obligations must cease collecting related taxes and fees.

The law states, “If a municipality fails to file a report as [required] within 12 months of the report being due, the municipality may not collect any further license revenue or any other taxes or fees in the police jurisdiction outside the corporate limits.”

Nearly 200 towns and cities with police jurisdictions have done what they need to do to comply with the law, but local licenses, taxes, and fees levied in the police jurisdictions of **127 municipalities** are no longer valid and should no longer be collected as of June 1, 2023. However, licenses, taxes, and fees within a municipality's city limits must still be collected and remitted, as must state and county licenses, taxes, and fees. Affected businesses should take note.

Fortunately, police jurisdiction rate changes shouldn't impact remote retailers registered to collect and remit the **Alabama Simplified Sellers Use Tax** (SSUT). The SSUT was instituted to simplify sales tax compliance for businesses with no physical presence in the state. Instead of collecting the specific rate in effect in hundreds of different jurisdictions, SSUT-registered businesses collect a flat 8% sellers use tax on all sales made into Alabama.

Remote sellers in Texas can elect to register to collect a single local use tax rate on top of the state use tax instead of collecting and remitting the local tax in effect at each transaction's destination address.



Businesses with a physical presence in Texas aren't eligible for the single local use tax, nor are marketplace providers that collect tax on behalf of third-party sellers.

SOURCE: *Texas Comptroller*

LOUISIANA'S "SIMPLE, EFFICIENT, AND COST-EFFECTIVE" SYSTEM IS A WORK IN PROGRESS

Louisiana has been working for years to simplify its complex **local sales and use tax system**, primarily in order to tax remote sales without placing too great a burden on out-of-state businesses. Progress is slow.

One of the first hurdles the home-rule state needs to overcome is its lack of a statewide sales and use tax collection system. Patrick Hennessey, Compliance Supervisor at Avalara, explains that there are currently three ways for customers to file and pay Louisiana sales and use tax:

1. **Businesses with a physical presence in the state** file state-level sales tax returns and payments with the Louisiana Department of Revenue, and they file parish-level sales tax returns with the individual parishes; these can be filed on a single website, **Parish E-File**, which facilitates electronic filing of state and parish/city sales and use tax returns. The parishes each have their own separate return for reporting sales and use tax for all localities within the parish.

2. **Taxpayers that meet the remote seller threshold** can file and pay all state and local sales and use tax through the **Louisiana Sales and Use Tax Commission for Remote Sellers** (RSC), which is the sole entity to collect sales and use tax from remote retailers as of July 1, 2020. The commission accepts only electronic returns and payments via its web-based portal and allows remote

sellers to submit one return containing all necessary state and local reporting information. **Remote businesses must apply to collect through the RSC**.

3. **Taxpayers below the remote seller threshold** that voluntarily collect should file and pay a **direct marketer** return with the Louisiana Department of Revenue (the tax rate is higher than the standard sales tax rate because local taxes aren't required).

The RSC has reduced the complexity of sales tax compliance for remote businesses with an obligation to collect. For companies with a physical presence in the state, simplification is still a work in progress.

Home-rule local governments in Louisiana would prefer to keep levying and administering local sales taxes themselves, but the Louisiana Legislature recognizes more centralized and simplified administration of local taxes is needed.

Act 685 (2022) expands the authority of the Louisiana Sales and Use Tax Commission for Remote Sellers to **collect nonremote sales and use tax** on behalf of state and local sales tax collectors that enter into contracts with the commission to do so. It also requires the commission to create a single electronic sales tax return once any such contract is executed.

It will take time to implement **simplification measures for nonremote sellers**; as of November 1, 2023, the **RSC FAQ** states businesses with a physical presence in Louisiana are "subject to state and local sales tax collection and remittance requirements."

Meanwhile, the Pelican State is moving forward with **other sales tax compliance simplification measures**. The **Louisiana Uniform Local Sales Tax Board** will begin overseeing a new uniform sales and use tax return and remittance system effective January 1, 2024. The board is tasked with designing, implementing, managing, maintaining, and supervising a single remittance system for all taxing authorities within a parish no later than January 1, 2026.

The board will also "develop a **uniform reporting schedule for audit reports** for all entities that serve as the single sales and use tax collector for all taxing authorities within a parish that are compensated based on the cost of collection" beginning with fiscal years ending on or after December 31, 2023.

While the transition is underway, the Louisiana Department of Revenue will continue to provide the existing local sales and use tax filing system (Parish E-File).

Under the current system, sellers need to remit to up to **64 different taxing jurisdictions in Louisiana**. So, Scott Peterson thinks Louisiana local tax collectors should be congratulated for thinking outside the historical tax collection structure.

COLORADO IS SIMPLIFYING LOCAL TAX COMPLIANCE FOR REMOTE RETAILERS

Like Alabama and Louisiana, Colorado is a home-rule state where local jurisdictions can independently administer local sales and use taxes. And as in Louisiana, Colorado created a centralized point of collection for remote sales tax.

The **Colorado Sales and Use Tax System**, or SUTS, provides a single point for sales tax registrations,

TAXATION JURISDICTIONS PARTICIPATING IN THE COLORADO SALES AND USE TAX SYSTEM (SUTS)

51	213	32	2	61
COUNTIES	MUNICIPALITIES	SPECIAL DISTRICTS	COMBINED CITY AND COUNTY JURISDICTIONS	of the participating jurisdictions are **home-rule, self-collecting jurisdictions**

SOURCE: *CDOR*

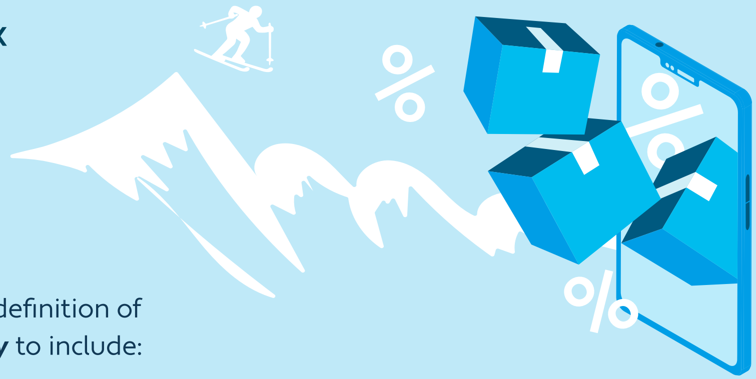
payments, and returns. The system can be used for state and state-administered local sales and use taxes as well as for self-collecting home-rule sales taxes for jurisdictions that have elected to **participate in SUTS**. Self-collecting home-rule municipalities must use a combined sales and use tax return in order for taxpayers to be able to **report local use tax through SUTS**.

Colorado SUTS is using Avalara Tax Research for Government, a self-service tax management tool that leverages Geographic Information System (GIS) technology to provide sales and use tax rates and tax information. This allows businesses to identify the taxing jurisdiction related to each sale of a taxable good or service, and to look up the sales tax rate in effect at each delivery address.

Local business license requirements in Colorado also recently got a whole lot easier for some businesses. As of July 1, 2023, local governments **cannot require retailers to apply for a local business license** if they have "incidental physical presence" or no physical presence in the jurisdiction. This helps simplify and reduce the costs of local tax compliance in the state for affected businesses, but it doesn't eliminate the burden of local tax compliance.

"It is great news for the taxpaying public," says Scott Peterson, "that state and local governments are working together to understand what makes sales tax complex."

IS MY BUSINESS REQUIRED TO COLLECT AND REMIT SALES TAX ON ONLINE SALES TO THE CITY OF BOULDER, COLORADO?



Ordinance 8457 expanded the definition of ***engaged in business in the city*** to include:

- Retailers or vendors in the state of Colorado making more than one delivery into the city within a **12-month period**; or
- Making retail sales **sufficient to meet** the definitional requirements of economic nexus.
- Generally, **economic nexus applies to any retailer that does not maintain a physical location in Colorado** and makes retail sales of tangible personal property, commodities, and/or services over $100,000 annually within the state.

SOURCE: *City of Boulder*

These measures are making Colorado an easier place to do business, but complications remain. For example, the **City of Boulder** has a local economic nexus ordinance that requires certain Colorado-based (but not Boulder-based) vendors to collect and remit online sales tax to the City of Boulder.

SALES TAX

State and local tax issues need digital solutions

The pandemic revealed how painfully dependent state and local governments are on in-person employees, the mail, paper, and outdated systems in general. Out of necessity, some government agencies began exploring digital or cloud-based systems after COVID-19 forced them to transition to a remote work environment – but old habits die hard.

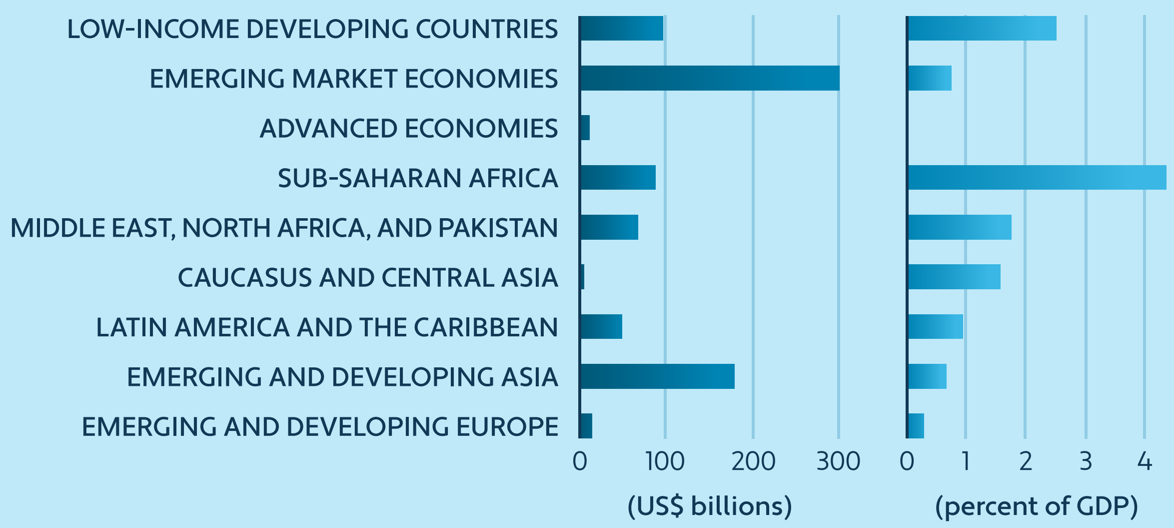
"Some governments have been slow to harness the potential of digital technology to improve delivery of public services and strengthen public finance," observed the **International Monetary Fund** (IMF) in September 2023, encouraging the public sector to accelerate and strengthen the adoption of digital solutions. "Digitalization enables governments to leverage technology to enhance revenue collection, improve efficiency of public spending, strengthen fiscal transparency and accountability, and improve education, health-service delivery, and social outcomes."

A few states are now using technology to streamline sales and use tax compliance. But

REQUIRED DIGITAL INFRASTRUCTURE INVESTMENTS

SOURCE: *IMF*

Achieving broad connectivity will entail significant investment in emerging and low-income developing countries, with sub-Saharan Africa requiring the greatest effort relative to economy size.



Scott Peterson has noticed many governments do business the same way they did 45 or 75 years ago. "Businesses will always adopt new things quicker than governments because of the difference in how decisions are made. This applies especially in technology."

That's starting to change, at least at the state level. At the National Association of State Chief Information Officers' annual conference in October 2023, many state CIOs shared how their **states are implementing generative AI**. While some CIOs are "too busy updating their outdated enterprise IT systems to even begin thinking about adoption," others are already using AI to streamline certain tasks.

As for the federal government, the Tax Foundation reports "the IRS is still **miles behind the technology curve**" despite investment in modernization.

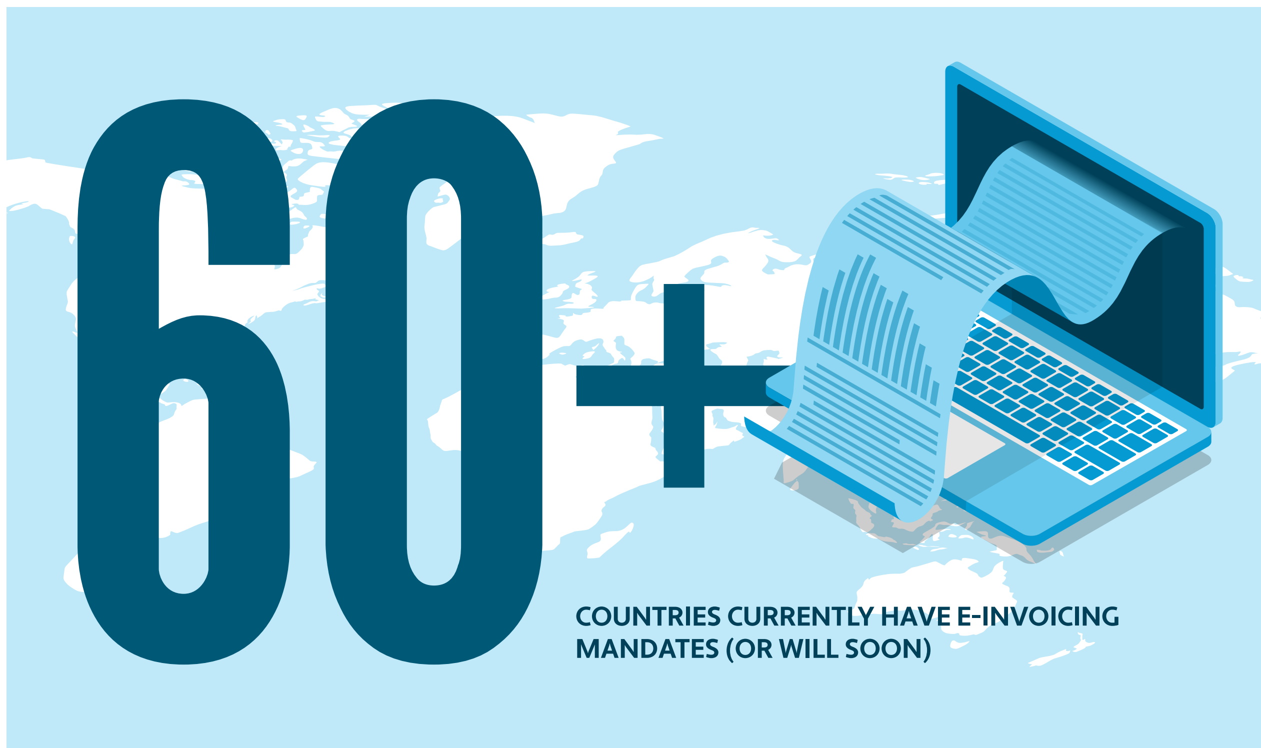
The **National Taxpayer Advocate** has criticized the IRS for failing to implement scanning technology to digitally input paper returns into its computer system. Although 78% of all tax returns are filed electronically with the IRS today, during the 2022 tax filing season, the IRS had a backlog of over 21 million paper returns that had to be keystroked into the system by hand. Not only is this inefficient, it increases the risk of errors.

Peterson says states are also starting to wonder why they still have paper returns. Of course, there are always reasons: States that still accept paper returns typically do so because it's politically challenging to mandate electronic filing, or because there's something about the state's computer system that would make it hard to get rid of paper returns.

What's more, some state tax authorities are questioning why they require businesses to file sales tax returns at all when all they want is the money. Indeed Brazil, which **implemented electronic invoicing in 2005**, is looking to use e-invoicing data to generate pre-filled tax returns.

An **e-invoice isn't the same as a paper invoice** that's been uploaded into a digital format; it's a digital file containing structured data designed to be automatically exchanged and processed by accounting and ERP systems. E-invoicing helps streamline tax reporting, increase tax collections, and reduce tax gaps (the difference between expected and actual tax collections). But while more than 60 countries currently have e-invoicing mandates (or will soon), e-invoicing remains somewhat of a foreign concept to state and local governments in the U.S.

Instead, U.S. businesses are blazing the country's e-invoicing trail.



E-INVOICES VS. PAPER INVOICES

SIMILARITIES

Both contain the same information:

- Credit notes
- Line items
- Payment terms
- Purchase order
- Purchase amount
- Shipping address

SOURCE: *Avalara*

DIFFERENCES

- E-invoices are issued, transmitted, and received in a structured electronic format that is designed to be read by machines
- E-invoices contain structured data designed to be automatically exchanged and processed by accounting and ERP systems

U.S. BUSINESSES EMBRACE E-INVOICING

Recognizing how costly and inefficient paper invoicing is for businesses, the Business Payments Coalition (BPC) launched an **e-invoicing pilot project** in September 2021. With support from the Federal Reserve, the BPC is creating a secure, open e-invoice delivery network for businesses to share electronic supply chain documents with one another. Avalara was a technical committee contributor for the **Business Payment Coalition's E-invoicing Exchange Market Pilot**.

"Businesses are interested in leveraging technology," says Liz Armbruester, EVP of Customer and Compliance Operations at Avalara. "And Avalara can be the bridge between business and government." Avalara intends to be **accredited by the Digital Business Networks Alliance** as an access point and service provider to facilitate the sending and receiving of electronic business documents over the new exchange framework.

Government tax agencies in the U.S. may be a long way from implementing any sort of e-invoicing mandates, but they're watching what the business community is doing with interest.

"The same technology revolution that has created challenges for tax authorities also offers incredible advantages," Armbruester observes. "Whether it's enabling easier, simpler ways to digitally file tax returns or leveraging more complex uses of technology like clustering algorithms, ensemble modeling, or machine learning, tax authorities can make significant strides in process efficiency while enjoying the resource gains. Taking advantage of technology can help tax agencies rethink their digital workflows and data management while also enabling a better taxpayer experience and deepening the relationships with key stakeholders in the compliance workflow."

In the meantime ...

... TAX AUTHORITIES ARE GETTING BACK TO BUSINESS WITH AUDITS

Tax agencies throughout the U.S. are resuming audits. Using lessons learned during the pandemic, they're increasing efficiency by consolidating travel and leaning into phone and online audits.

The **Inflation Reduction Act of 2022** provides roughly $80 billion in **additional IRS funding** over the next 10 years, with more than **$45 billion earmarked for enforcement**. Some of the effects of that money could trickle down to states: If the IRS requires a taxpayer to amend a federal income tax return, for instance, the taxpayer may need to amend their state income tax return as well; so, although the enforcement money doesn't go directly to states, states could benefit.

The IRS will also continue to collaborate with state tax administrators and software and tax professionals to increase security measures and **protect against identity theft**.

Businesses should bear this enhanced scrutiny in mind when grappling with compliance.

SALES TAX

What else could affect sales tax in 2024?

Though we give it the old college try, it's impossible for us to include everything happening with sales tax today, or to predict everything that will transpire in the year to come.

Here are some of the topics we plan to track as 2024 unfolds:

- **Severe weather** will cause more tax filing delays
- States will continue to grapple with the **nature and taxability of NFTs**
- States will examine tax policy as it pertains to **ticket sales** and confront tax challenges concerning collectibility, transparency, and enforcement
- More states may crack down on **junk fees**

How Avalara can help

Avalara can help you account for tax changes and improve tax compliance for your business. Learn more about our automated solutions for calculating tax rates, preparing returns, and managing documents.

EXPLORE SOLUTIONS

Discover more tax changes in our industry sections.

UP NEXT: RETAIL

Retail

Ongoing supply chain challenges and growing demands for environmentally responsible business practices are just two of the numerous issues retailers must navigate in 2024. There will also be new sales tax holidays, new retail delivery fees, and as always, a host of taxability and tax rate changes.

RETAIL

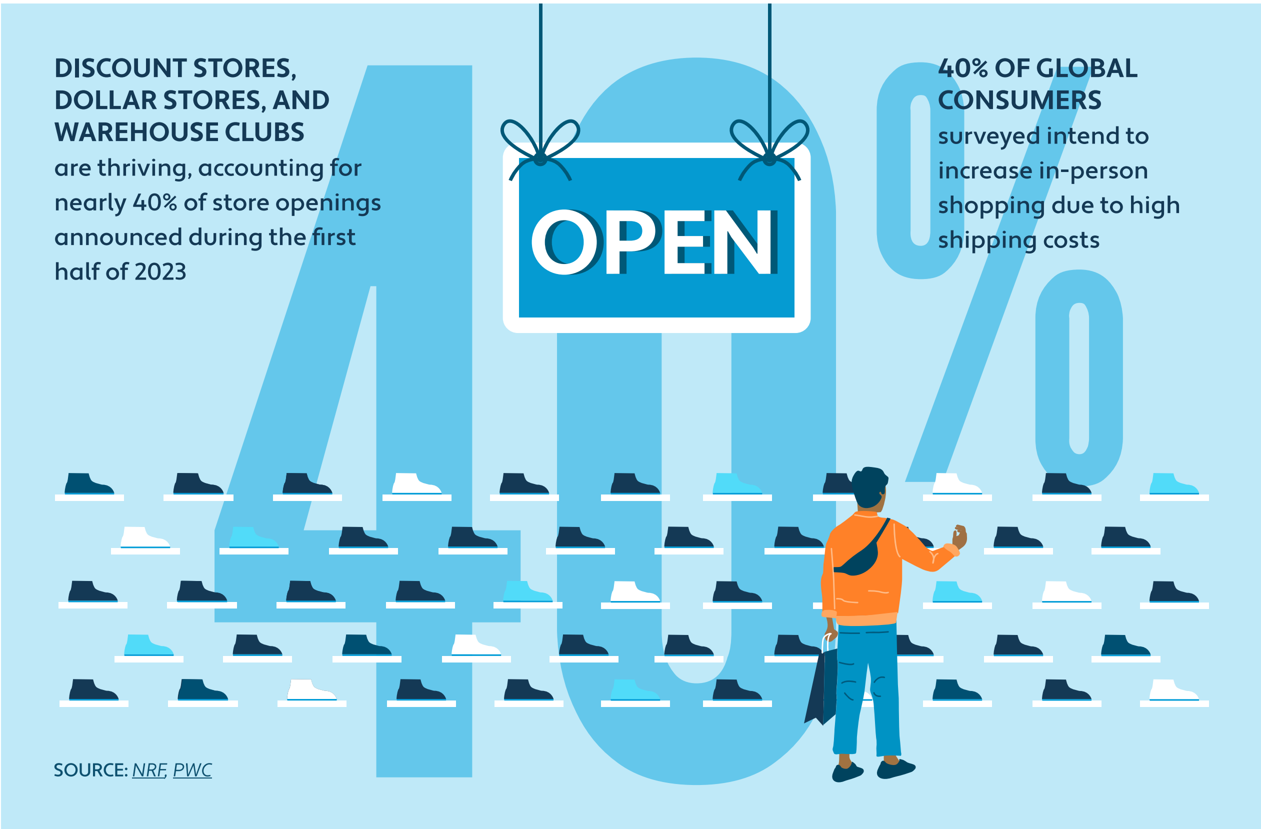
Introduction

It might be an exaggeration to say these are the best of times *and* the worst of times for retailers, but positive and negative indicators for the retail industry certainly are afoot.

Let's start with the positive.

Monthly retail sales in the U.S. are still growing, up 0.7% in September 2023 over August and up **3.8%** year over year. The country's **Top 100 retailers** had all grown as of July 2023, "at more or less the same rate." And U.S. retail sales (minus automotive) were projected to rise **3.7%** during the holiday season, November 1 to December 24, 2023. So that's good.

Barclays is "**bullish on retail for 2024**": The bank predicts apparel, ecommerce, and specialty retail to perform well in 2024 as inflation subsides and inventory pressures recede. **InvestorPlace** also expects apparel and automotive to perform well, along with specialty retail. What's more, discount stores, dollar stores, and warehouse clubs are thriving, accounting for nearly **40% of store openings** announced during the first half of 2023.



There are other reasons to be optimistic. The growing popularity of *recommerce* – sales of used or "pre-loved" items – is good both for the wallet and the environment. Artificial intelligence (AI) and digitalization are improving efficiency in a host of ways, from **forecasting demand** to **communicating with customers** to **streamlining logistics**. And though there's been a rash of store closings, as we'll explain, 40% of surveyed global consumers intend to **increase in-person shopping** due to high shipping costs.

Now for the negative.

Bankruptcies. High rents. Inflation. Wage increases. Persistent staff shortages. Retail shrink. Facing these and other challenges, retailers may open fewer stores and close more stores than usual. **More than 2,800 stores** could shutter in 2023 – far fewer than the **9,300** that closed in 2019, but more than 2022's **2,603** closures. Some retailers, like **national pharmacy chains**, are closing more stores than other retailers.

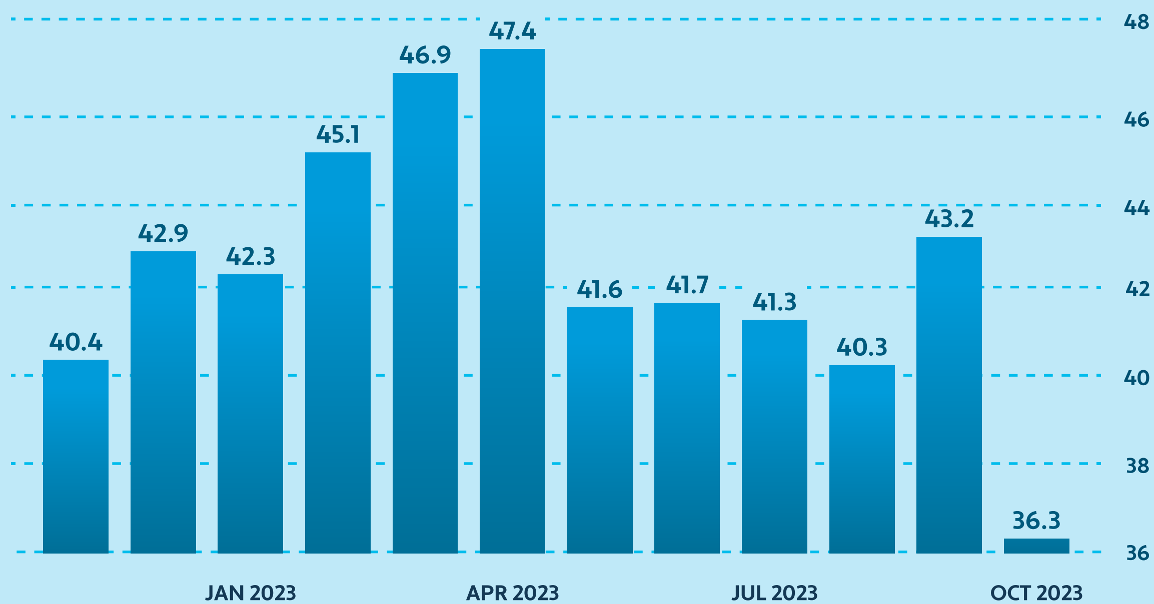
Looking ahead, UBS analysts anticipate the closing of **50,000 retail stores** by 2027 if 25% of online orders are fulfilled by a bricks-and-clicks store. If online sales grow to account for 28% to 29% of retail sales, up to 130,000 stores could close. Sobering numbers indeed (though on a bright note, surviving stores could end up doing more business).

Not as many people seem to be looking on the bright side these days. In October 2023, the IBD/TIPP Economic Optimism Index "**plummeted**" to 36.3 from September's 43.2 and was well below the market forecasts of 41.6. October marked the 26th consecutive month of economic pessimism and the reading hit its lowest point since August 2011. (The **IBD/TIPP Economic Optimism Index** is based on a survey of 1,200 adults and is the first gauge of consumer confidence each month.)

Whatever goes down in 2024, agility, digitalization, and an omnichannel strategy will serve retailers well.

UNITED STATES IBD/TIPP ECONOMIC OPTIMISM INDEX

Based on a survey of 1,200 adults and the first gauge of consumer confidence each month



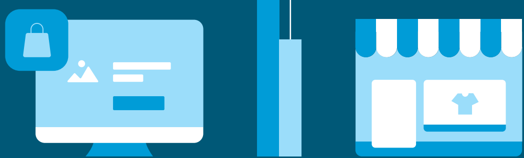
SOURCE: *Trading Economics*

Retail

ECOMMERCE IS EXPECTED TO OUTPERFORM BRICK-AND-MORTAR

6.7%
ecommerce YOY increase

2.9%
brick-and-mortar YOY increase



SOURCE: Retail Insight Network

MCOMMERCE SALES

Mobile commerce could account for 43.2% of U.S. ecommerce sales in 2023 and approach

50% IN 2027

SOURCE: Insider Intelligence

MORE THAN **60%** of consumers surveyed say they'd pay more for a product with sustainable packaging

SOURCE: McKinsey & Company

1 IN 5 SURVEY RESPONDENTS PLANNED TO USE BUY NOW, PAY LATER TO PURCHASE GIFTS DURING THE 2023 HOLIDAY SEASON

SOURCE: Industry Dive

ONLINE HOLIDAY SALES

$211.7B IN 2022

SOURCE: Industry Dive

PROJECTED **$221.8B** IN 2023

RETAIL

Ups and downs in the supply chain

INVENTORY NEEDS RETURN TO "NORMAL"

Many businesses **stockpiled inventory** during the global COVID-19 supply chain crisis, if they had the space and budget to do so and could get their hands on goods; the just-in-time inventory strategy that had served them well for years made for bare shelves. With supply chains somewhat more secure, some businesses are returning to the just-in-time model, **shedding inventory** and trimming warehouse capacity that's no longer needed.

For instance, The Home Depot could save **$500 million** in fiscal year 2024 by reverting to pre-pandemic capacity and shaving operating costs. And apparel company PVH is "targeting a 25% decrease in its inventory-to-sales ratio by the end of 2024." CEO Stefan Larsson explained in the Q2 2023 **earnings call**, "Our supply chain improvements continue to accelerate and will provide us with drastically improved inventory to sales ratio over the coming years."

It's good to see the supply chain stabilizing, but there will likely be more taxing times ahead.

THE HOME DEPOT COULD SAVE $500 MILLION IN FISCAL YEAR 2024 BY REVERTING TO PRE-PANDEMIC CAPACITY AND SHAVING OPERATING COSTS

SOURCE: *Industry Dive*

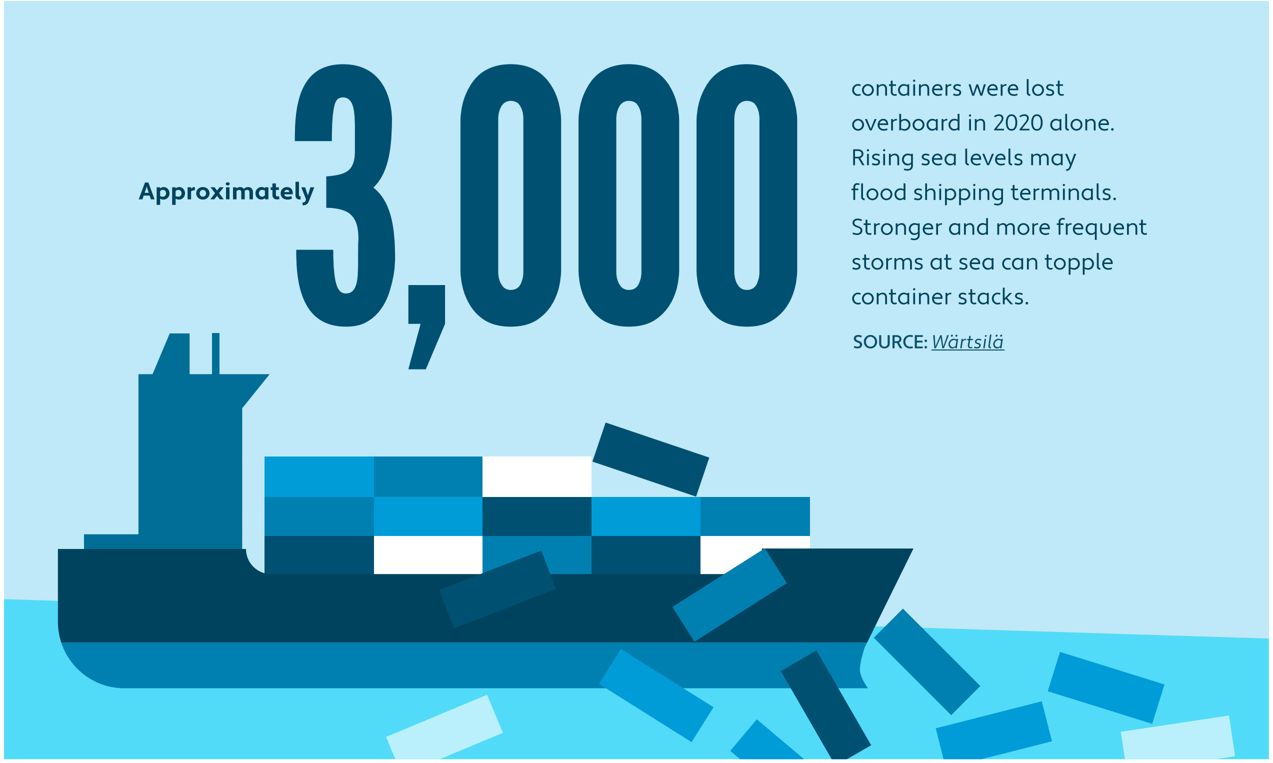
CLIMATE CHANGE BRINGS NEW CHALLENGES FOR THE SUPPLY CHAIN

Drought slowed **shipping traffic** through the Panama Canal in 2023. Average wait times for vessels started creeping up during the summer after the maximum ship weight and number of **daily crossings** were reduced to conserve water. If drought conditions continue, as is likely given El Nino weather patterns, restrictions could seep into 2024.

This is troubling news for the U.S., which receives about two-thirds of **Panama Canal traffic**.

And drought isn't the only worry, for **climate change** can impact maritime transportation in a variety of ways. Extreme weather can force vessels to take lengthy and costly detours. Rising sea levels may flood shipping terminals. Stronger and more frequent storms at sea can topple container stacks; approximately **3,000 containers** were lost overboard in 2020 alone. Heat waves expand piers, soften pavement, and deform rail tracks at ports.

Consider those possibilities – and the fact that approximately **90%** of goods traded internationally are shipped by sea.



containers were lost overboard in 2020 alone. Rising sea levels may flood shipping terminals. Stronger and more frequent storms at sea can topple container stacks.

SOURCE: *Wärtsilä*

STRIKES AND THEFT THREATEN TO UNDERMINE SUPPLY CHAIN STABILITY

United Parcel Service (UPS) narrowly averted what could have been a crippling strike in July 2023. This was good news for ecommerce, as a strike would have directly affected many online retailers' ability to fulfill orders.

According to **Digital Commerce 360**, 65.6% of Top 1,000 sales are by retailers using UPS. In 2022, nearly $25 billion in online sales came from retailers that use UPS exclusively for fulfillment. FedEx and the U.S. Postal Service would have been hard-pressed to pick up the slack had the strike occurred.

The automobile industry hasn't been as fortunate. A **United Auto Workers (UAW) strike** that began September 15, 2023, was still in full swing on October 13, when UAW President Shawn Fain vowed to make walkouts "more financially painful and less predictable for the Big Three automakers." It took until November 20, 2023, for the last of the strikers to **ratify their new contract**.

Strikes have affected other industries as well, including aerospace, airlines, drugstores, healthcare providers, and entertainment. As a result, 2023 will likely go down as a banner year for strikes: There were **453,000 U.S. workers** on strike at some point between January 1 and October 5, 2023, more than double 2022's strike count of 224,000.

What 2024 will bring is anyone's guess.

And then there's theft, which is as much or more of a problem along the supply chain as it is in stores. There were **566 cargo theft incidents in the United States** during the second quarter of 2023, a 57% year-over-year increase compared to Q2 2022. The average loss value per reported incident was $428,409, 55% higher than the value lost during the previous quarter.

The majority of cargo thefts in Q2 2023 took place near warehouses and distribution centers, as well as in unsecured parking lots, and company truck yards and premises. There was a 17% year-over-year increase in theft of full truckloads in the second quarter, and 127 more fictitious pickups, a highly specialized form of cargo theft.

Technology could help deter cargo theft. Using mobile apps to check trucks in and out and to quickly report theft can increase the likelihood of recovering stolen cargo. Hiding GPS trackers in freight trucks enables cargo to be tracked in real time. In fact, "visibility, traceability, and location intelligence" is one of the top five "**digital supply chain**" management trends for 2024.

Nevertheless, theft has become an enormous problem – and it's vexing for retailers.

TECHNOLOGY COULD HELP DETER CARGO THEFT

Using mobile apps to check trucks in and out and to quickly report theft can increase the likelihood of recovering stolen cargo.

SOURCE: *Transport Topics*

RETAIL

Beleaguered brick-and-mortar

RETAIL SHRINK AND ESCALATING VIOLENCE PLAGUE RETAILERS

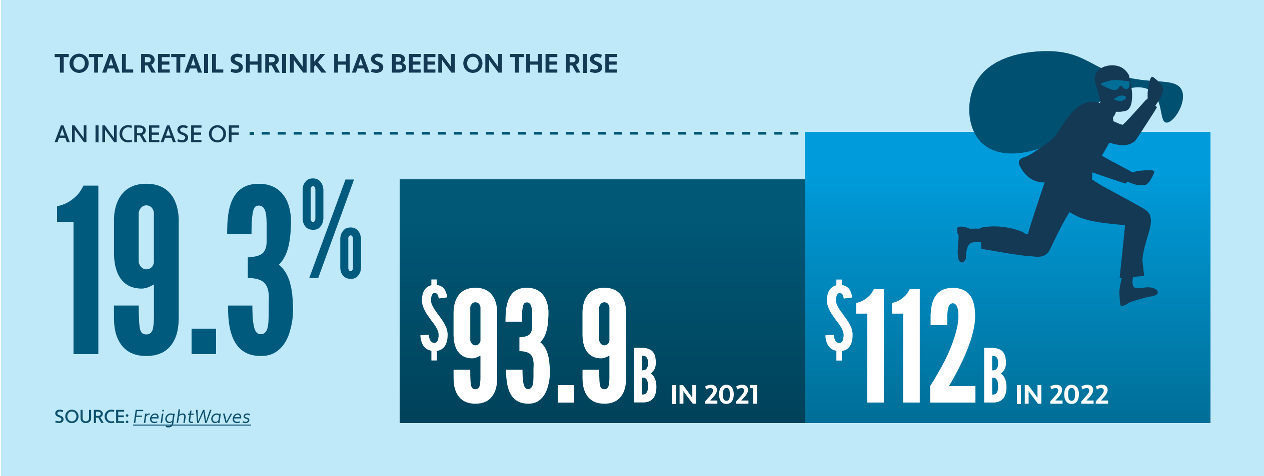
Retail shrink is the loss of inventory to causes other than a sale, anything from breakage to **containers lost at sea** to theft. It's always been a thing, but theft has gained notoriety in recent years: The internet is full of videos of people running into stores, grabbing items off shelves, and legging it.

If you haven't experienced such thievery, consider yourself fortunate.

About **50% of known crimes are not reported** to the police, according to a 2023 study of organized retail crime investigators and multistore loss prevention managers. Get your head around this: "80.92% of the respondents who estimated that less than 80% of incidents are reported said it was because police will not respond, investigate, and/or arrest."

Reported or not, the effects of crime are real. Target closed **nine stores across four states** on October 21, 2023, saying, "We cannot continue operating these stores because theft and organized retail crime are threatening the safety of our team and guests, and contributing to unsustainable business performance." Citing similar safety and security concerns, Nike **permanently closed a flagship store** in Portland, Oregon, in 2023. Retail theft has also **cut into the profits** of Dick's Sporting Goods.

Total retail shrink has been on the rise, according to an industry survey conducted by the **National Retail Federation** (NRF). Losses grew from $93.9 billion in 2021 to more than $112 billion in 2022, a **19.3% increase**. And while the financial losses are significant, NRF Vice President for Asset Protection and Retail Operations David Johnston cited violence and safety concerns as the main priority for all retailers.



SOURCE: *FreightWaves*

Businesses are trying all sorts of strategies to prevent and mitigate the losses. Of the retailers surveyed by NRF, 34% increased internal payroll, 46% added more third-party security personnel, and 53% increased their technology and software solution budgets. More than half, 54%, provide employee workplace violence training.

Not wanting to fight this alone, businesses and industry advocates are calling for government assistance and policy reform. Before deciding to permanently shutter its Northeast Portland location, for instance, Nike asked the city to **assign off-duty police officers** to the store. Apparently it was only after the city declined to do so that Nike made the decision to leave the neighborhood for good.

California lawmakers answered the call, though not by providing additional security. On September 30, 2023, Governor Gavin Newsom signed a **bill** aiming to increase worker safety throughout the state by obligating employers to develop **workplace violence prevention plans** as part of the state's Occupational Safety and Health Administration (OSHA) Injury and Illness Prevention Program. The new requirements take effect July 1, 2024.

Urged on by retail and trade associations, other states are **going after organized retail crime**. At least 11 states enacted retail crime laws in 2022 or 2023: **Alabama**, **Florida**, **Illinois**, **Indiana**, **Minnesota**, **Nevada**, **New Mexico**, **North Carolina**, **Oklahoma**, **Oregon**, and **Virginia**.

Congress is also interested in reducing crime, both online and in stores. Had it been enacted, the **Combating Organized Retail Crime Act of 2023** would have made it easier for prosecutors to bring theft cases to federal court. And the federal Integrity, Notification, and Fairness in Online Retail Marketplaces for Consumers Act (**INFORM Consumers Act**), which did become law, requires online marketplaces to do **more to prevent sales of counterfeit, unsafe, and stolen goods**.

Because remember all that **stolen freight** we talked about earlier? A lot of it ends up being sold via online marketplaces.

TECHNOLOGY MAY HELP DETER RETAIL THEFT

Major retailers like CVS, Lowe's, and Walmart are **using technology to help combat retail crime**. Autonomous security robots, facial-recognition cameras, license-plate readers, predictive analytic software, and radio-frequency identification (RFID) tags are among the tools helping deter criminal activity, identify thieves, and track stolen goods.

Tech vendors are starting to weave AI into existing predictive technologies too. For example, AI-assisted cameras overlooking parking lots can instantly analyze images to identify suspicious activity, then activate lights and warnings to scare off potential thieves. Artificial-intelligence surveillance systems can **pick people out of thousands of hours of footage**.

But it's unclear how effective such technology really is – or whether some of it should even be permitted. Cities from Boston to San Francisco **don't allow police officers** to use facial recognition technology and the **American Civil Liberties Union** is fighting more widely to stop the use of face recognition technology, calling it "an unprecedented threat to our privacy and civil liberties."

Expect to hear more about this issue as 2024 unfolds.

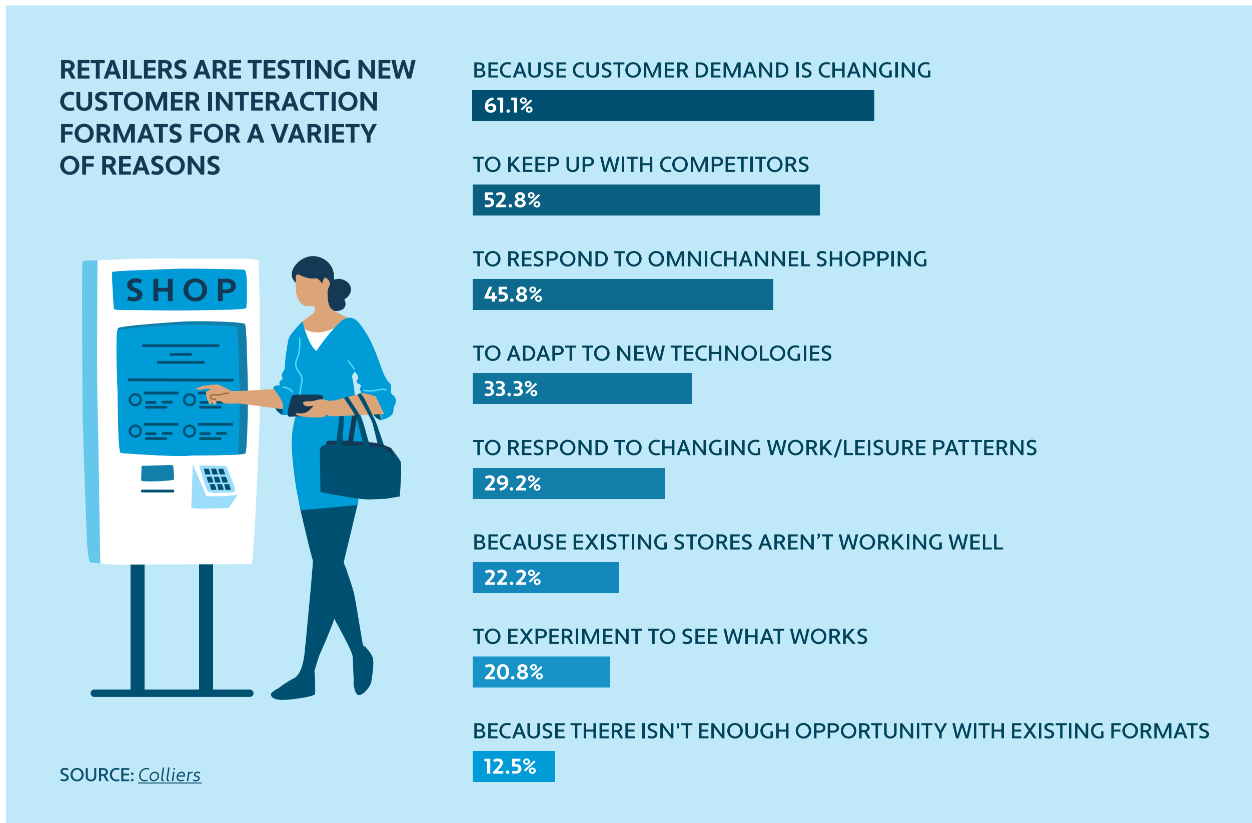
RETAIL

Bricks and clicks: Omnichannel is essential (and brick-and-mortar still matters)

An omnichannel strategy is pretty much essential today: “81% of consumers expect a brand’s product content experience to be similar wherever they interact with that brand,” according to a **Consumer Product Content Benchmark** report.

Omnichannel is not the same as multichannel. While the latter allows customers to interact with brands in more than one form, like in-store and online, omnichannel retail provides a connected experience for consumers who sometimes shop in-store, sometimes from a laptop, and **more and more from their phones**. Omnichannel retailers recognize customers whether they’re buying direct, from a third-party marketplace or social media site, or in a virtual world.

And increasingly, retailers are blurring the lines between channels. **Colliers** reports that 39% of all retailers plan to test new retail formats over the next couple of years, and the new format retailers are most interested in testing “is an omnichannel store that enables them to introduce new features and facilities, such



as collection points for online orders, ordering kiosks, and drive-up/curbside facilities."

Examples of innovative retail include:

- Nike Live stores, digitally connected living retail labs where Nike tests new products and services, and shoppers are encouraged to use the Nike app
- IKEA Plan and Order points, which are a fraction of the size of standard IKEA stores and aim to prioritize convenience and simplify shopping for urban consumers
- Panera To Go, a digital-first store offering all-digital ordering and no dine-in seating
- TikTok's pop-up shop in London, which features book, home, living, and tech products from its TikTok Shop feature

Why would retailers open new brick-and-mortar stores when 50,000 to 130,000 existing stores could close by 2027? Because "retailers that opened brick-and-mortar locations experienced an average sales increase of **37%** in their respective geographic areas."

Experimental retail is taking businesses into new worlds too. Crocs partnered with the experiential platform Obsess to offer a **metaverse shopping experience** for its Jibbitz charms, decorative accessories for the unique footwear. The 3D "**Jibbitz Customizer**" allows consumers to create their own custom Crocs in the metaverse, and ultimately purchase a physical version of their customized clog. This isn't the brand's first foray into virtual commerce, and Crocs certainly isn't the only brand **exploring this new frontier**.

OMNICHANNEL SELLING CAN COMPLICATE SALES TAX COMPLIANCE

While omnichannel selling benefits consumers, it can **complicate sales and use tax compliance** for the retailer.

You're more likely to trigger **sales tax nexus** – a connection that establishes an obligation to collect sales tax – in states where you sell through multiple avenues. It's easier to reach a state's **economic nexus threshold** when you sell through marketplaces, social media sites, and the metaverse as well as through your own website. And if you sell through a third party, **inventory held in a marketplace-owned fulfillment center may create physical presence nexus**.

Once registered for sales tax in a state, businesses need to keep track of changing tax rates, regulations, and rules to ensure tax is collected as required for each taxable transaction. With more than 13,000 sales and use tax jurisdictions in the United States, this is easier said than done. After all, in 2023 alone there were:

- 11,192 sales and use tax rate updates in the U.S.
- 85,836 taxability updates in the U.S. and Canada
- 98,910 sales tax holiday rule updates in the U.S.

Retailers that make exempt transactions in addition to or in lieu of taxable sales face additional challenges: They need to collect a valid **exemption certificate** or resale certificate from the buyer, ideally at the time of sale, and keep that document up to date. The more streamlined this process, the better: It's no fun to hound a customer for a valid certificate after a sale is complete; it's a hassle to refund sales tax after the fact; and it would be a shame to lose the sale to a competitor that can accept a digital certificate at the point of sale.

Failure to provide a valid certificate at the time of sale can also backfire for the buyer. To wit, the District of Columbia Office of Tax and Revenue (OTR) determined that a buyer was *not* eligible for a refund of nearly $1 million in sales taxes paid because it didn't provide the seller with a resale certificate *at the time of the purchase*, as required by D.C. Code § 47-2010. The OTR's decision was **upheld by the courts**.

Reporting sales tax can also be more challenging for omnichannel retailers because it necessitates consolidating information from multiple sources. Furthermore, reporting requirements vary from state to state. Some states require retailers to report both direct and marketplace sales; in other states, retailers need only report their direct sales. You may be required to make prepayments in some states, file electronically in others, and so on.

Since trying to manually manage sales tax from disparate systems is an exercise in frustration, savvy omnichannel sellers use **cloud-based sales tax software** that:

- Automatically updates product taxability rules and rates, using geolocation technology to pinpoint the point of sale
- Validates and manages exemption certificates digitally
- Aggregates sales data from all sales systems

Keep in mind that retailers based outside of the U.S. can establish sales tax nexus too. The Avalara **sales tax risk assessment** can help you determine if and where you need to register to collect and remit sales tax, wherever your business is based.

Getting sales tax right is essential because it impacts customer experiences – and retaining customers is as critical as finding new ones.

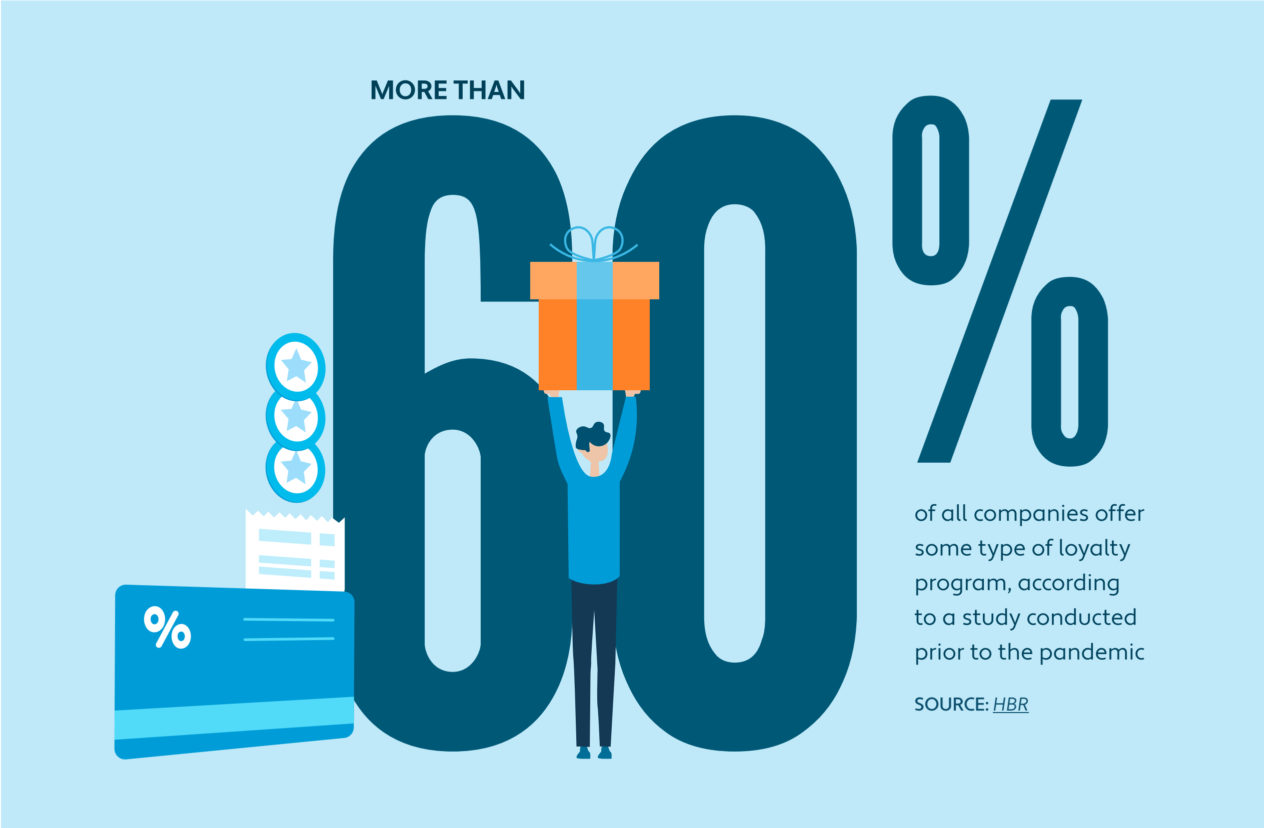
RETAIL

Do loyalty programs pay?

Under Armour has a **loyalty program** for the first time ever. Meanwhile, Amazon is making its loyalty program less exclusive by expanding **grocery delivery services** to non-Prime members. So, do loyalty programs work?

More than 60% of all companies offer some type of loyalty program, and the average American consumer belongs to more than 14 customer loyalty programs, according to a study conducted by Harvard Business Review prior to the pandemic. Yet another survey tells us only **42%** of brand executives think their customer loyalty programs are effective.

After analyzing two years of purchase data from more than 10,000 customers at a top U.S. retailer, researchers determined "**loyalty programs do increase profitability** – but only for some customers, and not the ones you might think." In this study, loyalty programs had little to no impact on "customers with high levels of past spending." However, they were found to increase spending by nearly 50% for "customers who were highly vulnerable to competitors."



The study also found loyalty programs to make a "significant difference" on two customer segments identified as *consolidators* and *upgraders*. After joining a loyalty program, consolidators started buying more products from the retailer, while upgraders bought more expensive or premium versions of products previously purchased from the retailer.

BUY NOW, PAY LATER

Allowing customers to buy now, pay later (BNPL) can also encourage loyalty to a brand.

BNPL programs are projected to drive **$17 billion** in online spending during the 2023 holiday season, a $3.5 billion year-over-year increase. According to research by Adobe, one in five survey respondents planned to use BNPL to purchase gifts during the 2023 holiday season, and BNPL spend could reach $782 billion on Cyber Monday alone.

The global BNPL market was valued at **$141.8 billion** in 2021 and is anticipated to have a 33.3% compound annual growth rate (CAGR) through 2026. Buy now, pay later programs basically function like a point-of-sale loan, but they generally aren't regulated as other loans are. That's starting to change.

In October 2023, the Council of the European Union adopted a **consumer credit directive** designed to "protect consumers from irresponsible lending practices that spread particularly in online environments" by ensuring consumers "have all the information they need, ... presented clearly, even for small-scale credit." The directive specifically includes loans below €200 and buy-now-pay-later products.

BNPL programs are also being scrutinized in the U.S. In September 2022, the **Federal Trade Commission** reminded that basic consumer protection ground rules apply to anyone playing "a role in the BNPL ecosystem." And in March 2023, the **Consumer Financial Protection Bureau reported** that although many borrowers use BNPL plans "without any noticeable indications of financial stress," BNPL borrowers tended to be "much more likely to be highly indebted, revolve on their credit cards, have delinquencies in traditional credit products, and use high-interest financial services such as payday, pawn, and overdraft."

Expect policymakers to take more interest in BNPL in 2024, and perhaps set additional regulations.

HOW SALES TAX WORKS WITH BUY NOW, PAY LATER PROGRAMS

Bear in mind that buy now, pay later programs can have sales tax implications. Retailers that offer or accept BNPL are generally responsible for determining whether and how sales tax applies to BNPL transactions. States do not take a uniform approach: Depending on the state, sales tax may be due on the full purchase at the time of the first payment, or a percentage of the tax due may be applied to each installment. Moreover, fees associated with BNPL may be subject to sales tax or they may be exempt.

Jeffrey Lutters, Director of Product Solution Engineering at Avalara, says BNPL is a new concept, so state tax law is still catching up. "Some states are grouping it with layaway rules; others are simply treating it as a straight sale, so all the tax is due up front."

Here's how some jurisdictions treat layaway sales: The District of Columbia requires vendors to report and remit sales tax on the entire sales amount at the beginning of the layaway, "when the sale, agreement, or other arrangement for transfer of the property from the vendor to the purchaser is made" (**D.C. Mun. Regs. 409**). The policy is similar in **Pennsylvania**, but in Arizona, tax must be collected when "title or possession transfers to the purchaser or at the time receipts from the transaction are determined to be nonrefundable, whichever occurs first" (**Ariz. Admin. Code R15-5-131**).

California is more like Arizona than D.C. or Pennsylvania: "There is no taxable sale until the full purchase price is paid, unless the parties agree that title will pass at an earlier date." Same goes for **Washington**, though there's no caveat for passing title to the buyer at an earlier date. In **South Carolina**, retailers collect sales tax incrementally; payments are "taxable in the month during which such amounts are received."

Whether buying now or later, if a transaction occurs online, the goods will likely need to be delivered. That's got some states looking to monetize retail delivery.

RETAIL

Retail delivery fee woes

Demand for urban last-mile delivery will likely grow by 78% by 2030, leading to 36% more delivery vehicles in the world's top 100 cities. Urban deliveries could add 11 minutes to daily commute times and increase carbon emissions by 30% without effective intervention, according to the **World Economic Forum**. And those statistics were published in January 2020, *before* the **spike in online sales** (and therefore deliveries) caused by the pandemic.

All these delivery vehicles are taking a toll on the nation's roads, and with **fuel tax revenues** declining as a result of improved fuel efficiency and the shift toward fully electric vehicles, new sources of revenue are needed. Enter retail delivery fees.

Colorado was the first state to implement a retail delivery fee (RDF). When it took effect on July 1, 2022, all businesses making retail deliveries of taxable goods by motor vehicle in the state were required to collect the 27-cent fee from customers and to separately state it on invoices. That proved mighty problematic because the **fee's initial requirements**

URBAN DELIVERY'S LOOMING CRISIS

78% projected growth of demand for urban last-mile delivery by 2030

36% more delivery vehicles in the world's top 100 cities

30% increase of carbon emissions

11 minutes added to daily commute

SOURCE: *World Economic Forum*

didn't fit neatly into most invoicing systems, and businesses weren't given much time to make the necessary changes.

The Colorado RDF also caused a kerfuffle for the Colorado Department of Revenue (CDOR) because CDOR was required by law to enforce the fee before it could work out many of the fee's collection and remittance details. When the department **fielded questions from taxpayers** on June 23, 2022, mere days before the fee took effect on July 1, 2022, there were questions it could not answer.

Colorado ultimately eliminated some of the most challenging requirements for retailers. As of April 1, 2023, businesses are not required to separately state the fee on invoices and may pay the fee on behalf of the purchaser. Moreover, new businesses and those with $500,000 or less of retail sales in the state are exempt from the Colorado retail delivery fee (which jumped to 28 cents on July 1, 2023).

Other states and even municipalities have been watching Colorado's RDF journey with interest, as states tend to do. **Minnesota enacted a retail delivery fee** in May 2023. Starting July 1, 2024, its **50-cent fee** applies to retail deliveries, defined as a delivery of "1) tangible personal property that is subject to state sales tax, and 2) clothing, except for diapers." The fee kicks in only if the pretax sale total of eligible items exceeds $100, and only once per transaction no matter how many items or shipments it takes to complete the transaction.

Taking a cue from Colorado, Minnesota provides an exception for retailers whose retail sales totaled less than $1 million in the previous calendar year, and for marketplace providers facilitating the sale of a retailer qualifying for the small seller exception. Minnesota also allows – but doesn't require – retailers to collect the fee from purchasers. Retailers that choose to collect it must separately list the fee on a receipt or invoice. All retailers subject to the fee must remit it to the commissioner of revenue on the same filing cycle required for sales tax.

That's not to say the Minnesota fee poses no compliance challenges. The fact that clothing is subject to the fee despite generally being exempt from Minnesota sales tax leads one to wonder whether clothing retailers will be required to obtain a Minnesota tax license. How will the fee be reported, and what will reporting look like for clothing retailers?

David Lingerfelt, Senior Director of Indirect Tax at Avalara, thinks we'll see more retail delivery fees. "Retail delivery fees are an easy way to raise the sales tax without raising the sales tax." And indeed, at least two online delivery fees were introduced in **New York** during the 2023 legislative session (one for the state and one for New York City), and **Washington** is studying the possibility of a retail delivery fee.

Retail delivery fees appeal to policymakers for several reasons: They could help reduce traffic congestion and reduce emissions from heavy delivery traffic. And of course they bring in revenue: Colorado estimates that its RDF will generate **$18.8 million** in revenue in its first two years, while Minnesota's fee could bring in **$46.4 million** in its first year alone.

That doesn't bode well for retailers. Businesses subject to such fees need to figure out whether and how to charge customers the fee. They also need to ensure their sales systems can capture any and all RDFs where applicable, based on the rules and rates set by each jurisdiction, and that they properly report both the fees and any sales taxes due on the fees. **Avalara** can help customers on both sides of the transaction.

RETAIL

Going green

Consumers may not like paying retail delivery fees, but some may be willing to pay a bit more for greener products.

According to the EY Future Consumer Index, 24% of GenZ and Millennials check brands' sustainability claims and 21% will stop buying a product if the brand isn't "making enough effort to help the environment." In another study, 75% of Millennials were found to be "eco-conscious to the point of changing their buying habits to favor environmentally friendly products."

That said, some consumers aren't willing to sacrifice their wallets for their ideals.

Key environmental, sustainability, and governance (ESG) issues for the retail industry include decarbonization, green contracts, greenwashing, supply chains, and the circular economy – the growing trend to reuse or resell products instead of discarding them. This is known as *recommerce*.

SOURCE: *White & Case*

RECOMMERCE

Revenue from global recommerce is on track to nearly double by 2027, reaching $350 billion, according to the **thredUP Resale Report**. It's also on track to grow three times faster than traditional retail through 2030.

This isn't a new phenomenon: In a 2022 **eBay report on recommerce**, 90% of buyers surveyed said they'd purchased pre-loved goods on eBay in the past year, and 90% of eBay sellers surveyed said reducing waste was an important aspect of recommerce. "In 2022, eBay recommerce resulted in 73,000 metric tons of waste avoided from landfills, 1.6 million metric tons of avoided carbon, and $4.6 billion in positive economic impact created by eBay's sellers and buyers."

Retailers that enter the recommerce space should pay close attention to the potential tax consequences. If you create a resale site, you may turn yourself into a marketplace facilitator and could end up liable for collecting and remitting the tax due on sales made through the site. When you consider that there were more than a **million active users participating in just one fashion brand's resale ecosystem** as of March 2023, it becomes clear how quickly tax liability can add up.

THE HIGH COST OF RETURNS

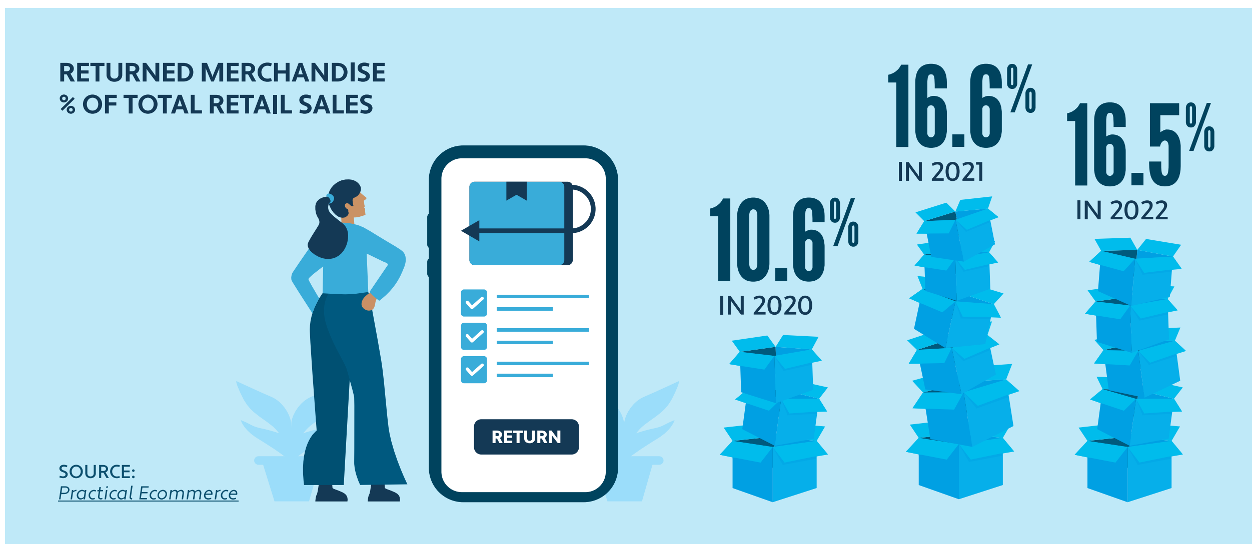
Keeping used products out of landfills is one good reason to encourage recommerce. Another is the high cost of processing returns. Of the retailers surveyed by Pollfish, 73% rank returns as a "**moderate-to-severe issue for their business**." Another survey found that online returns cost retailers an average of **21% of order value**, and that 70% of retailers are "actively trying to lower the cost of returns."

These are sobering statistics, especially when you consider that **returned merchandise** jumped from 10.6% of total retail sales in 2020 to 16.6% in 2021 and 16.5% in 2022.

Returns can be a hassle for sales tax compliance too. Both customers and tax authorities will check to see that sales tax was refunded or credited as permitted by law. Since sales tax policies related to returns vary by state, as sales tax policies generally do, this can be hard on retailers doing business in multiple states.

Consumers in Connecticut aren't entitled to a refund of sales tax (at the rate paid on the original sale) if the return occurs more than **90 days after the original purchase date**, and that's not uncommon. If the return takes place within the 90-day window, the amount of sales tax due depends on the amount of the refund. For instance, a consumer who paid $6.35 in sales tax on a $100 bicycle would only be refunded $5.72 if the retailer takes a $10 restocking fee out of the $100 sales price and therefore refunds the consumer $90 instead of the full $100 they initially paid.

That's just one scenario; there are many others. If you're responsible for collecting and remitting sales tax in multiple states, you need to understand and comply with the requirements in each of those states. **Automating the collection and remittance of sales tax** can help.



BAG FEES

Also implemented for environmental reasons, bag fees can be another bugbear for retailers.

Most bag fees are local, and they aren't new. Examples include the 10-cent fee on plastic and paper bags in **Batavia, Illinois**, the 15-cent fee for paper shopping bags and $1 fee (minimum) for new reusable bags in **Edmonton, Alberta, Canada**, and the 5-cent tax on each disposable plastic bag provided to customers in some cities and counties in Virginia. Local bag fees are generally administered by the local taxing authority, but Virginia's disposable plastic bag tax is collected, administered, and enforced by the **Virginia Tax Commissioner**.

While local bag fees will undoubtedly proliferate, **Colorado** and **Washington** could start a new trend with statewide bag fees.

THE COLORADO BAG FEE

Between January 1, 2023, and January 1, 2024, stores in Colorado may give customers a recycled paper or single-use plastic carryout bag at the point of sale if and only if the customer pays a fee for the bag. The fee is 10 cents per bag unless there's a higher local fee in the county or municipality where the store is located. Certain exceptions apply.

Once collected, the bag fee must be tucked away for good keeping. Stores are required to remit 60% of the carryout bag fee to the municipality or county in which the store is located, on a quarterly basis, starting April 1, 2024. That's unusual, to say the least. Retailers may retain the remaining 40%.

Also unusual: Although it's a state fee, retailers don't remit any portion of the fee to the Colorado Department of Revenue.

The bag fee isn't subject to Colorado state sales tax or state-administered local sales taxes. However, it may be subject to local sales tax in self-collecting home-rule municipalities. Retailers are encouraged to contact local finance departments for additional information.

For the most part, single-use plastic carryout bags will be banned in Colorado as of January 1, 2024, but the fee will continue to apply to paper bags.

THE WASHINGTON BAG FEE

Washington state currently requires retail establishments to collect an 8-cent fee for every compliant paper bag or reusable film-plastic carryout bag they provide or sell. Starting January 1, 2026, the 8-cent charge will jump to 12 cents per bag for reusable carryout bags made of plastic films, but will remain 8 cents per compliant paper bag. Any local bag fees in Washington state that were enacted prior to April 1, 2020, and are still in effect will be replaced by a **statewide bag fee** beginning January 1, 2026.

Though retained by the retailer, the Washington fee must be separately stated and reported as a retail sale. Washington sales tax applies to the state bag fee even if the goods being purchased, like food for home consumption, are exempt. Bag fees are considered a retail sale and must be reported under the Retailing Business and Occupation (B&O) tax classification and under the retail sales tax classification. However, the retailer can take a deduction for the compliant carryout bag charge, so retailers don't have to pay B&O tax on the charge. The bag charge is retained by the retailer, not remitted to the departments of revenue or ecology.

Retailers subject to bag fees in different parts of the country must be sure to collect, report, and tax them as required. Like the retail delivery fees discussed earlier, these fees can become yet another compliance burden for affected businesses.

"Bag fees and the retail delivery fees were created for entirely different reasons," notes Scott Peterson, VP of Government Relations at Avalara, "but complexity is what they have in common."

Now, let's move on to the fun stuff, like sales tax trends.

RETAIL

Taxability trends

Sales tax exemptions are in vogue, new sales taxes are out – except where they're not.

SALES TAX EXEMPTIONS SWEEP THE COUNTRY

Most states started 2022 with **pockets full of cash**, and with pockets still jingling at the end of the year, most **expected revenue to continue to grow** through 2023. The governor of Rhode Island kicked off 2023 with a proposal to reduce the state sales tax while his colleague in South Dakota sought to eliminate the sales tax on groceries, as did the governor of Kansas. Several other states, including Arizona and Kansas, sought to exempt diapers and/or feminine hygiene products.

So, what happened?

SEVERAL STATES REDUCED OR ELIMINATED TAXES ON FOOD

The Illinois **1% sales tax on groceries** was suspended from July 1, 2022, through June 30, 2023. And food for home consumption and essential personal hygiene items became exempt from state sales and use tax in **Virginia** as of January 1, 2023, though the 1% local option tax still applies.

Kansas cut the state sales tax on food, food ingredients, and certain prepared food from 6.5% to 4% effective January 1, 2023; the state sales tax rate on food drops to 2% on January 1, 2024, and will hit 0% starting January 1, 2025.

There's more. The Alabama state **sales tax on food** dropped from 4% to 3% on September 1, 2023. It will decrease from 3% to 2% effective September 1, 2024, provided there's "sufficient growth in the state Education Trust Fund." City and county sales tax rates will be equal to their general sales tax rate in effect as of June 15, 2023, though local governments can lower the tax rate on food in 25% increments any year in which there's sufficient growth in their local general fund.

Instead of reducing the tax on groceries, as the governor wanted, **South Dakota** reduced the state sales tax rate from 4.5% to 4.2% starting July 1, 2023. The Mount Rushmore State could further reduce or even eliminate the state sales tax rate on groceries if the issue makes the November 2024 **ballot** in the form of an initiated constitutional amendment and an initiated measure. We'll have to wait and see.

Food isn't the only product benefitting from exemptions.

TWO MORE STATES EXEMPT SEPARATELY STATED DELIVERY CHARGES

Most delivery charges and installation charges are exempt from **Michigan sales tax** as of April 26, 2023, as long as the seller separately states the charges on the customer invoice and keeps books and records showing how tax was levied and calculated for these transactions. Likewise, separately stated delivery charges are exempt from **Kansas sales tax** effective July 1, 2023.

Don't be surprised if there are more taxability changes related to delivery services in 2024.

THERE ARE NEW EXEMPTIONS FOR FAMILY (ESPECIALLY WOMEN'S) HEALTH PRODUCTS

North Carolina's new **budget**, which became law without the governor's signature on October 3, 2023, establishes a **sales and use tax exemption** for breast pumps, breast pump collection and storage supplies, and repair and replacement parts. Bottles, nursing bras, and other related products remain taxable unless part of a qualifying, prepackaged breast pump kit. The exemption took effect November 1, 2023.

A sales and use tax exemption for baby and toddler products took effect in **Florida** on July 1, 2023. Qualifying products include baby and toddler clothing, changing tables, diapers, playpens, and safety gates, as well as breast pumps and related products. A few months later, on October 1, 2023, diapers for children, car seats, and several other children's products became **tax free in Ohio**.

The state sales tax ceased to apply to essential personal hygiene products in Virginia as of January 1, 2023, though the **1% local option sales tax** still applies to these sales. And as of September 1, 2023, Texas no longer taxes certain **family care items**: baby bottles and wipes, breast milk pumping products, feminine hygiene products, maternity clothing, and wound care dressings.

We expect to see more so-called **pink tax** exemptions in 2024. Advocacy groups in Arkansas have put forward a ballot initiative to exempt **feminine hygiene products and diapers** from state sales tax. (Arkansas is one of about 20 states where period products are subject to tax.) And the Streamlined Sales Tax Governing Board (SSTGB, or simply SST) is looking to clarify definitions related to **menstrual products** and to specify whether newer products like period underwear and menstrual cups should be exempt.

SALES TAX EXEMPTIONS PROMOTE GUN SAFETY

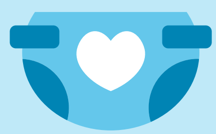
Certain **firearm safety devices** are exempt from Florida sales and use tax as of July 1, 2023, and **Tennessee** exempts firearm safes and firearm safety devices from sales and use tax starting November 1, 2023. The Volunteer State test-drove the exemption with a lengthy **sales tax holiday** for gun safes and safety devices, which lasted from July 1, 2021, through June 30, 2023.

Michigan adopted a sales tax exemption for firearm safety devices in 2023 with the enactment of Senate Bills **81** and **82**, but the exemption will sunset December 31, 2024. Sales tax exemptions for gun safes and/or safety devices were also proposed in more than a half dozen other states, including **Alabama**, **California**, **North Carolina**, **Ohio**, **Oklahoma**, **Rhode Island**, and **Wisconsin**.

NEW TAX EXEMPTIONS FOR WOMEN'S AND FAMILY HEALTH PRODUCTS

NORTH CAROLINA

Breast pumps



FLORIDA

Toddler products (clothing, diapers, safety gates, etc.)

OHIO

Diapers, car seats

TEXAS

Baby bottles, maternity clothing

SOURCE: *North Carolina General Assembly*, *Florida Department of Revenue*, *Avalara*, *Texas Comptroller*

MISCELLANEOUS SALES TAX EXEMPTIONS

It's common for states to exempt certain products or services just because they can. (OK, not really, but it would take too long to dive into each and every origin story.) For 2023, these one-offs include:

- A **Florida** sales and use tax exemption for services provided by certain small private investigative agencies (effective July 1, 2023)
- A **Kentucky** exemption for marketing services (effective retroactively to January 1, 2023)
- A **New Mexico** gross receipts tax exemption for ebook licenses purchased by public libraries (effective July 1, 2023)
- An Ohio exemption for the **consumer-grade fireworks fee** (effective October 1, 2023)
- A **Texas** exemption for the service of furnishing an academic transcript (effective October 1, 2023)

2024 will almost certainly bring another slew of sales tax exemptions.

NEW SALES TAXES TAKE A STAND

Of course, it's not all about sales tax exemptions. Numerous states are broadening sales tax to previously untaxed goods and services.

California will apply an 11% tax to gross receipts from retail sales of ammunition, firearms, and firearm precursor parts starting July 1, 2024. **New York** and **Wisconsin** are also interested in imposing a tax on firearms manufacturers for each firearm made that's offered for sale in the state.

CALIFORNIA NEW TAX

11%

on gross receipts from retail sales of ammunition, firearms, and firearm precursor parts

SOURCE: *Avalara*

WISCONSIN PROPOSED TAX

.5%

on manufacturer's list price for each firearm made by the manufacturer that is offered for sale in the state

SOURCE: *Wisconsin Legislature*

NEW YORK PROPOSED TAX

11%

on gross receipts from the retail sales of ammunition, firearms, or "major components of a firearm" in the state

SOURCE: *Avalara*

North Carolina established a new tax on for-hire ground transport services. The **transportation commerce tax** will apply to exclusive and shared for-hire ground transport services starting July 1, 2025.

Texas didn't create a new tax on fireworks, but it now allows **fireworks to be sold for Diwali**: Firework sales, which are subject to Texas sales tax, are now permitted beginning five days before the first day of Diwali and ending at midnight on the last day of Diwali.

Kentucky clarified how tax applies to certain services that were made taxable by a law enacted in 2022. We now know that as of January 1, 2023, extended warranty services (including prewritten computer software access services) are subject to sales tax. And tax applies only to **limited testing processes** performed in a laboratory, rather than general testing services. Kentucky also updated **sourcing guidelines** for retail sales of services subject to Kentucky sales and use tax.

There's a good chance some states will pass laws related to ticket sales and fees in 2024 (largely thanks to the ticketing bots that snatched up Taylor Swift concert tickets at the speed of light then resold them at extortion prices). According to a **podcast** by the National Conference of State Legislatures, "the snafu became the catalyst for 24 states and Puerto Rico to consider 70 bills addressing ticket sales and fees." Some of those could involve sales tax.

RETAIL

Practically every day is a (sales tax) holiday … in Florida

The past couple of years have seen a lot of activity centered on sales tax holidays. Remember that impressive stat from earlier? There were 98,910 U.S. sales tax holiday rule updates in 2023.

David Lingerfelt expects we'll see more sales tax holidays, longer sales tax holidays, and broader sales tax holidays in 2024. Consumers love them after all. "Sales tax holidays are becoming less about tax policy and more about politics," Lingerfelt says. "They make a political statement and have tax implications." He finds this to be particularly true in Florida and Texas, and he predicts we'll see more in other states in the coming years.

Florida's sales tax holidays are legendary in the sales tax community, and with good reason. The state has taken to offering six or seven overlapping sales tax holidays per year, putting retailers in a pickle.

For instance, would a flashlight sold on September 3, 2023, qualify for Florida's **Freedom Summer** sales tax holiday, the **disaster preparedness**

FREEDOM SUMMER SALES TAX HOLIDAY

MAY 29–SEPTEMBER 4, 2023

An exemption-eligible flashlight is subject to a $30 price cap

SOURCE: *Florida Department of Revenue*

DISASTER PREPAREDNESS SALES TAX HOLIDAY

AUGUST 26–SEPTEMBER 8, 2023

An exemption-eligible flashlight is subject to a $40 price cap

SOURCE: *Florida Department of Revenue*

TOOL TIME SALES TAX HOLIDAY

SEPTEMBER 2–8, 2023

An exemption-eligible flashlight is subject to a $50 price cap

SOURCE: *Florida Department of Revenue*

sales tax holiday, or the **tool time** sales tax holiday? It matters, because flashlights eligible for the exemption are subject to a $30 price cap under the first, a $40 price cap under the second, and a $50 price cap under the third. Plus, each sales tax holiday starts and ends on a different date.

What's a retailer to do?

Florida and other states also seem to be testing how far they can stretch a sales tax holiday before it breaks. Historically, these temporary exemptions last a day, a weekend, or perhaps a week. But months? A year? Two years? Is a sales tax holiday really just a vacation from sales tax if it lasts that long? (Try taking a year or two off work and see what happens.)

A Streamlined Sales Tax advisory council is **studying sales tax holidays**. Among other issues, it's seeking answers to such questions as: "What is [a] 'sales tax holiday' versus a 'regular sales tax exemption with a sunset?'" and "Is there a maximum amount of time an exemption needs to be in place for it not to be a sales tax holiday?" It will be interesting to learn what the council decides.

For now, at any rate, sales tax holidays are hard on retailers in general, and online sellers and marketplaces in particular. According to the **National Conference of State Legislatures**, sales tax holidays are a burden for some businesses: "The administrative work required to exempt eligible products from sales tax can be time-consuming and difficult because the list tends to be very specific and limited to a dollar amount. Additionally, businesses must ensure that local taxes are applied when local governments opt out of state sales tax holidays."

A sales tax holiday can also be a "gotcha" moment for businesses not registered to collect and remit sales in the state. If sales increase markedly during a sales tax holiday, as they're wont to do, that can catapult a retailer over an economic nexus threshold and into sales tax liability land.

Per the Retailers Association of Massachusetts, the Bay State's annual sales tax holiday generates about **half a billion dollars** each year for Massachusetts businesses. Given that figure, the tax-free weekend could certainly lead to new sales tax obligations for out-of-state online sellers – including marketplace facilitators.

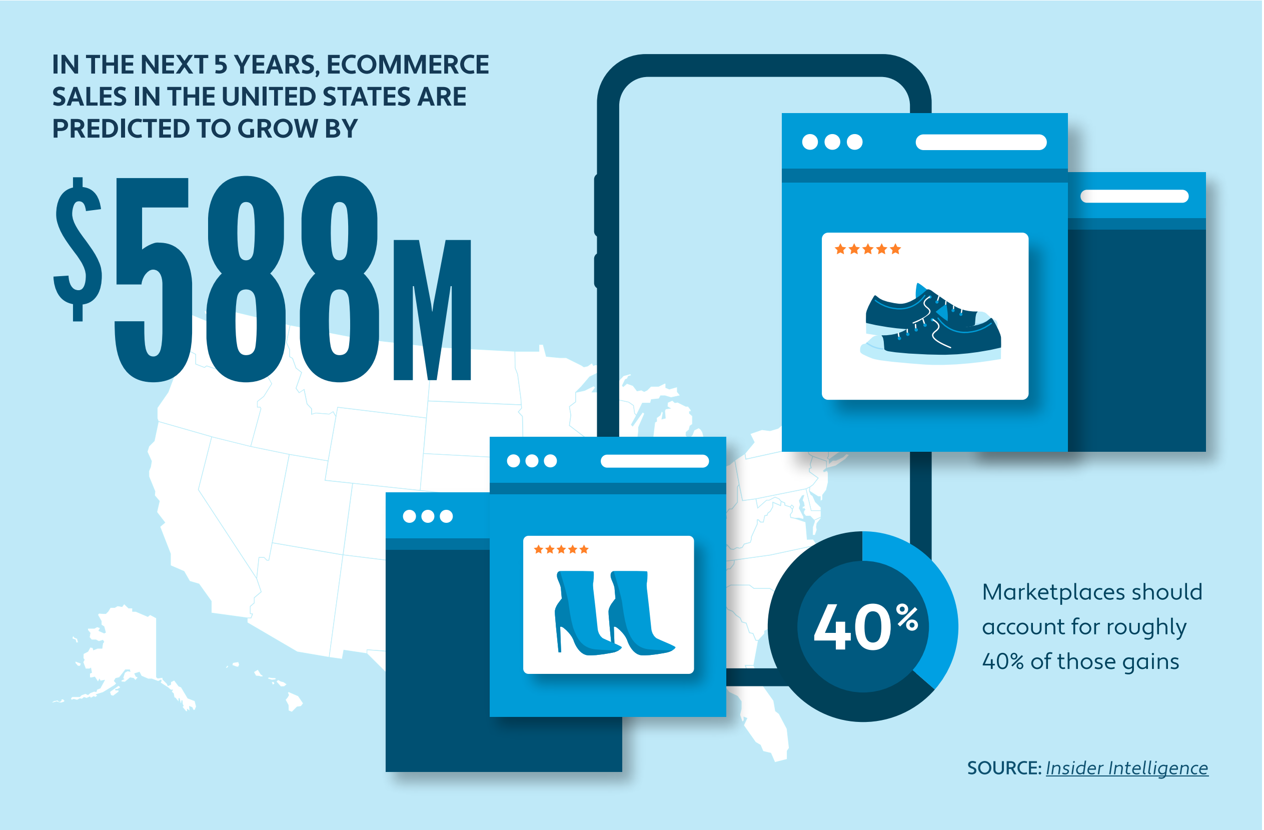
RETAIL

Online sales tax: Marketplace makeover

Ecommerce sales in the United States are predicted to grow by **$588 billion** over the next five years, and marketplaces should account for roughly 40% of those gains. Some of the growth will come from established brands and retailers opening their own third-party marketplaces. This rapid gain of market share is one reason states are refining their marketplace facilitator laws.

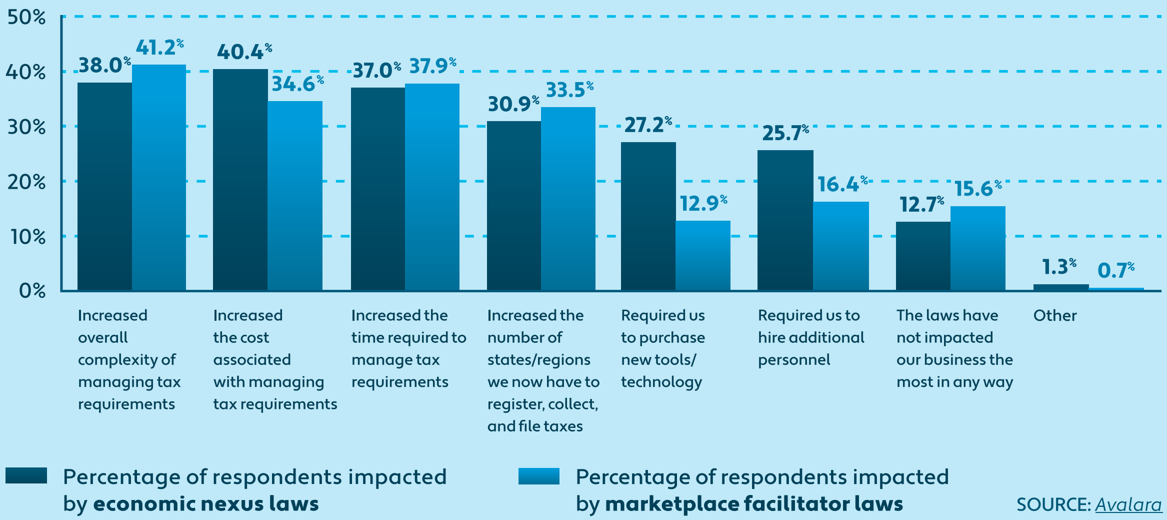
All states with a general sales tax, plus Puerto Rico, Washington, D.C., and numerous local jurisdictions in Alaska, have marketplace facilitator laws requiring marketplace facilitators to collect and remit the sales tax due on all sales made through the platform. These **marketplace facilitator laws** were supposed to not only increase sales tax collections for states, but to simplify sales tax compliance for third-party sellers (if not for the marketplaces).

Have marketplace facilitator laws actually simplified compliance for businesses? Not so much.



IMPACT OF ECONOMIC NEXUS LAWS AND MARKETPLACE FACILITATOR LAWS ON BUSINESSES

Q: In what ways, if any, have economic nexus laws and marketplace facilitator laws impacted your business the most? (Select up to three)



SOURCE: *Avalara*

In a **survey** of 1,000 U.S. and U.K. businesses conducted shortly before the fifth anniversary of the U.S. Supreme Court decision in South Dakota v. Wayfair, Inc., 41.2% of respondents reported an increase in overall complexity of managing tax requirements as a result of marketplace facilitator laws. Furthermore:

- 34.6% of respondents said marketplace facilitator laws have increased compliance costs
- 37.9% said marketplace facilitator laws have increased the time required to manage tax requirements
- 33.5% said marketplace facilitator laws have increased the number of states/regions they now have to register, collect, and file taxes

One reason for the complexity: Many states are grappling with what is, and what isn't, a marketplace for sales tax purposes. They're also continually tweaking the taxes marketplaces are required to collect and remit. The complexity will likely grow as marketplaces make like Captain Kirk and boldly go where no marketplace has gone before (i.e., to **virtual worlds**).

WHAT IS, AND WHAT ISN'T, A MARKETPLACE?

There are all sorts of marketplaces in businesses today. If you're moving, you can find strong backs on a marketplace like Craigslist or Thumbtack. Want help cleaning your gutters, painting a room, or putting together IKEA furniture? Check out a marketplace like Taskrabbit. Should you have an insatiable appetite for toys, marketplaces like eBay and Etsy, as well as niche platforms like FiddlePiddle, have you covered.

For the most part, marketplace facilitator laws are clear when it comes to a marketplace that sells new or used taxable tangible personal property. The waters get muddier in other situations, such as when a marketplace deals in beverage alcohol, food delivery, lodging, or rideshares, or when a platform connects buyers and sellers but doesn't process payments. If any of these situations apply to you, keep in mind that while you may not be subject to sales tax in State X or Y today, you could be tomorrow.

Moreover, states are continually modifying their marketplace facilitator laws.

In August 2023, the California Department of Tax and Fee Administration (CDTFA) issued a long-awaited **final regulation** governing the taxability of marketplace transactions. In a nutshell, any business handling the fulfillment, payment, or storage of products for sale is a marketplace facilitator responsible for California sales tax, as is any business listing products, setting prices, providing customer service, or taking orders on behalf of a marketplace seller.

That's not all. The CDTFA considers you to be a marketplace facilitator if you accept orders and transmit offers between a buyer and a seller, operate a marketplace website, or provide virtual currency to buyers so they can pay sellers. On the other hand, if you merely refer a buyer to a seller (via a link, ad, or direct referral), you're not a marketplace facilitator in the eyes of California.

And if you're a delivery network company, meaning you maintain an internet website or mobile application to facilitate delivery services for the sale of local products, you may elect to be treated as a marketplace facilitator – or not.

WHAT TAXES AND FEES ARE MARKETPLACE FACILITATORS RESPONSIBLE FOR?

Well, it depends.

Louisiana eliminated the 200-or-more transaction threshold for economic nexus starting August 1, 2023. As of the same date, it limited the $100,000 sales threshold to remote retail sales instead of "all retail sales," and limited the time frame for notification of an approval or denial of a marketplace facilitator application to not later than 30 business days after receipt of the completed application.

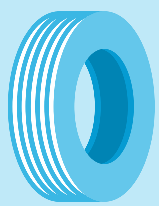
The Pelican State also clarified, in an **information bulletin** published September 8, 2023, by the Louisiana Sales and Use Tax Commission for Remote Sellers, that marketplace facilitators are required to maintain documents such as exemption certificates and taxability information.

Furthermore, marketplace facilitators are responsible for the tax due on all transactions facilitated in the state even if the third-party seller has a physical presence in Louisiana. This is true whether the marketplace facilitator itself has a physical presence in or outside of Louisiana. According to the bulletin, "Sales occurring on a marketplace that are facilitated by a marketplace facilitator are remote sales, requiring sales tax to be remitted to the Commission."

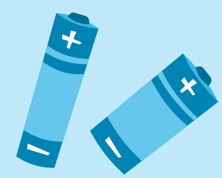
A third-party seller with a physical presence in Louisiana, however, is responsible for any tax due on their direct (i.e., non-marketplace) sales in the state.

Other jurisdictions have also clarified that online marketplaces are responsible for collecting and remitting this or that tax. For example, as of January 1, 2023, **marketplace facilitators must collect and remit other taxes** administered by the state of Oklahoma, including lodging taxes. Marketplace facilitators in **British Columbia** are responsible for collecting and remitting Provincial Sales Tax (PST) on certain online marketplace services. And back in **California**, marketplace facilitators are generally required to collect and remit the California battery fee (CBF), electronic waste recycling fee, lumber products assessment (LPA), and tire fee.

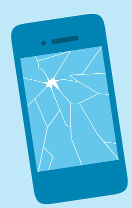
CALIFORNIA MARKETPLACE FACILITATORS ARE GENERALLY REQUIRED TO COLLECT FEES WHEN MAKING RETAIL SALES



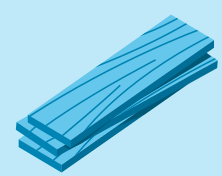
TIRE FEE



BATTERY FEE



ELECTRONIC WASTE RECYCLING FEE

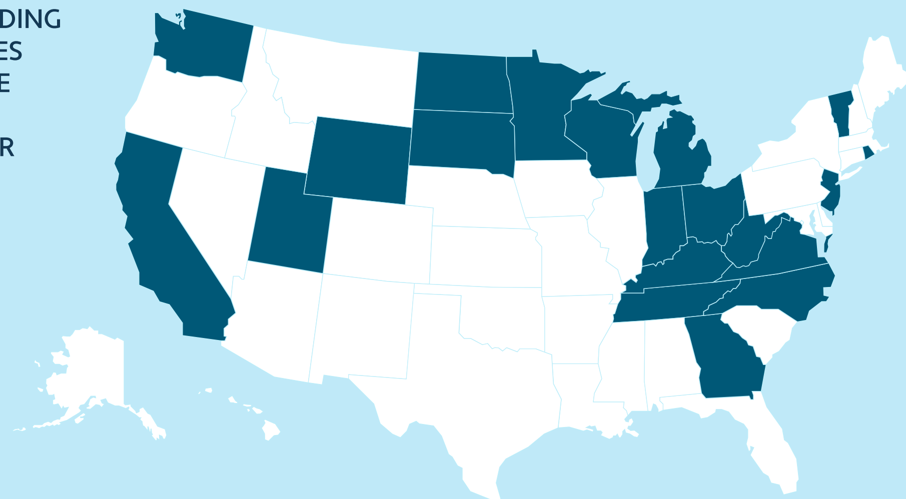


LUMBER PRODUCTS ASSESSMENT

SOURCE: *CDTFA*

STATES WHERE HOLDING INVENTORY* CREATES PHYSICAL PRESENCE NEXUS FOR THE THIRD-PARTY SELLER

*This includes inventory stored in a marketplace facilitator's facility and managed by the marketplace



SOURCE: *Avalara*

MARKETPLACE INVENTORY UPDATE

A factor retailers should think about when considering selling through a marketplace is what happens with the inventory. Should a third-party seller be liable for sales tax in a state if the seller's only connection, or nexus, is the presence of inventory in a marketplace fulfillment center in the state? Ask California, Washington, Wisconsin, and some other states, and the answer will almost certainly be, "yes."

California courts have effectively **authorized** the CDTFA to **hold unregistered out-of-state sellers liable for sales tax** based on inventory held in a warehouse in the state, even when the seller didn't realize a third-party was storing its inventory in California.

And California is just one of roughly 20 states where holding inventory in the state, including in a third-party fulfillment center or warehouse, can establish a **sales tax obligation for a third-party seller**. Others include the SST member states of Georgia, Rhode Island, and Vermont.

Marketplace sellers have challenged this stance, and they've found success in at least one state. In September 2022, the Commonwealth Court of Pennsylvania held that an out-of-state business whose only connection to Pennsylvania is inventory stored in an Amazon warehouse in the state does *not* have nexus for Pennsylvania sales and use tax or personal income tax. The Pennsylvania Department of Revenue did not appeal the decision.

With the decision in **Online Merchants Guild v. Hassel, No. 179 M.D. 2021**, the Commonwealth Court of Pennsylvania became the first court to rule against a state in an inventory nexus case. There will likely be more legal battles ahead. After a California court dismissed the Online Merchants Guild (OMG) **suit** against California inventory nexus then refused to rehear the case, the OMG **petitioned** the U.S. Supreme Court to take up the case. It's still waiting for a response.

MARKETPLACES AS PROTECTORS OF THE PEOPLE

Marketplace facilitators aren't merely responsible for tax compliance. New consumer protection mandates established under the federal **INFORM Consumers Act** require marketplaces to **do more to prevent online shopping fraud** and protect consumers from counterfeit, stolen, and unsafe goods. It took effect June 27, 2023.

"Counterfeit and stolen products have become pervasive on major online marketplaces," according to a Congressional **report** on the INFORM Consumers Act. Under the new law, an online marketplace must:

- Collect and verify certain information from high-volume third-party marketplace retailers
- Provide additional information for some high-volume sellers
- Provide "clear and conspicuous" reporting options for customers
- Comply with data privacy and security requirements

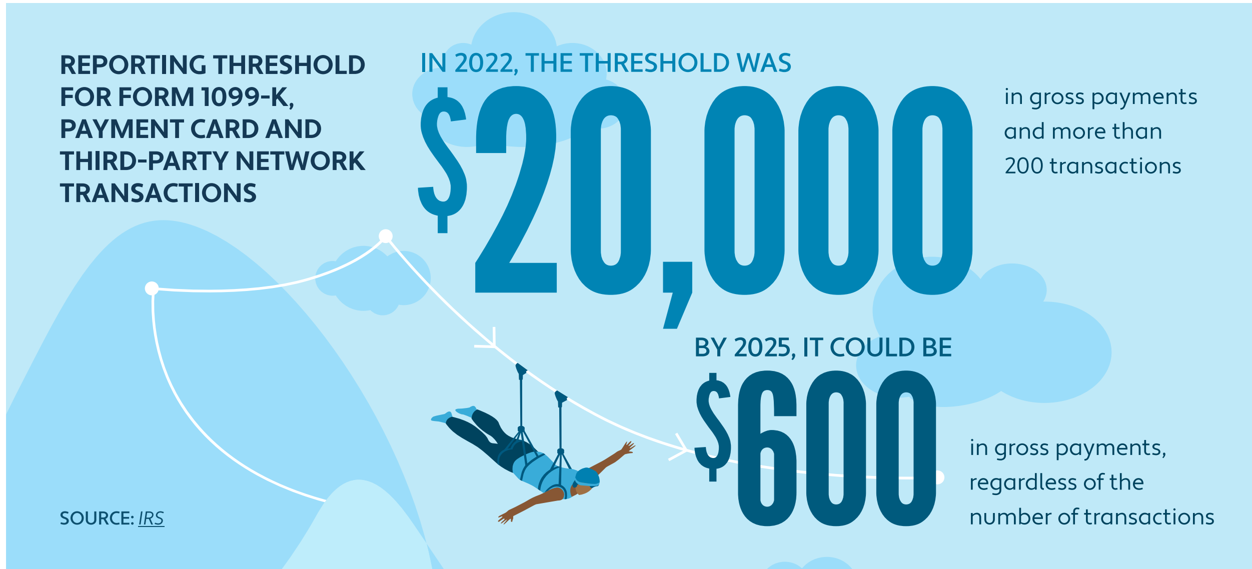
Under the INFORM Consumers Act, "high-volume sellers" are those with at least 200 discrete sales or transactions and an aggregate total of $5,000 or more in gross revenues during any 12-month period in the previous 24 months.

NEW 1099-K REPORTING REQUIREMENTS ARE COMING ... EVENTUALLY

Both marketplace facilitators and marketplace sellers must also start to prepare for several new **1099-K** reporting requirements on the horizon. A Form 1099-K is a report of payments received during the year from one of two types of reportable payment **transactions**:

1. Payment card transactions (credit, debit, or stored value cards such as a gift card), or
2. Third-party network transactions (payment apps or online marketplaces, including third-party payment settlement organizations)

Currently, online marketplaces, payment apps, and payment card companies are required to file a Form 1099-K with the IRS and provide a copy to any payee (e.g., marketplace seller) that receives over $20,000 in more than 200 transactions in a calendar year. The $20,000/200-transaction threshold was scheduled to drop considerably – to more than **$600** with no transaction threshold – for **tax years starting 2023**. However, on November 21, 2023, the **IRS** announced a delay of the new $600 Form 1099-K reporting threshold for third-party settlement organizations.



This is the second time the $600 threshold has been pushed back; it was originally set to take effect for tax year 2022.

The IRS now says it will phase in the changes. For tax year 2023, 1099-K reporting will be required only if the taxpayer receives over $20,000 in more than 200 transactions in 2023. That threshold will likely drop to $5,000 for tax year 2024, and to $600 in a subsequent year. The IRS is also looking to update the Form 1040 and related schedules for 2024 to "make the reporting process easier for taxpayers."

Whether $20,000, $5,000, or $600, the threshold includes payments for personal items sold, goods sold, services provided, or property rented through any:

- Peer-to-peer payment platform or digital wallet
- Online marketplace (sale or resale of clothing, furniture, and other items)
- Craft or maker marketplace
- Auction site
- Car-sharing or ride-hailing platform
- Real estate marketplace
- Ticket exchange or resale site
- Crowdfunding platform
- Freelance marketplace

Gifts or reimbursement of personal expenses from friends and family should **not be reported** on a Form 1099-K, as they are not payments for goods or services. The IRS recommends these types of payments be noted as non-business in the payment apps, when possible.

Once the 1099-K threshold is lowered, it will affect many small marketplace sellers that never reached the higher threshold of 200 transactions and $20,000 in aggregate sales. It will also affect individuals who receive $5,000 and eventually $600 or more in payments for personal items that are considered "payments for goods and services" and **sold through a payment app** (e.g., PayPal, Square, Venmo) or online marketplace.

OTHER CHANGES AFFECTING 1099S

The threshold for electronic **filing of 1099s** and other forms is being reduced from **250 returns down to 10 or more returns** in a calendar year, beginning in 2024 for tax year 2023. The threshold applies to a taxpayer's combined number of returns. As a result, many small businesses that previously filed paper returns will be required to file electronically.

For example, if you hired 15 independent contractors over the course of the year and paid each one more than $600, you'd need to electronically file 15 1099-NEC forms. If you have five employees and hired five contractors, paying each one more than $600, you'd need to electronically file five W-2s and five 1099-NEC forms. However, if you have only two employees and hired no independent contractors, you could file the five W-2s on paper.

Per the **IRS**, "To determine if you meet the 10 or more threshold to electronically file:

- Identify how many information returns of any type covered by TD 9972, you need to file during a calendar year
- If 10 or more, you MUST file electronically"

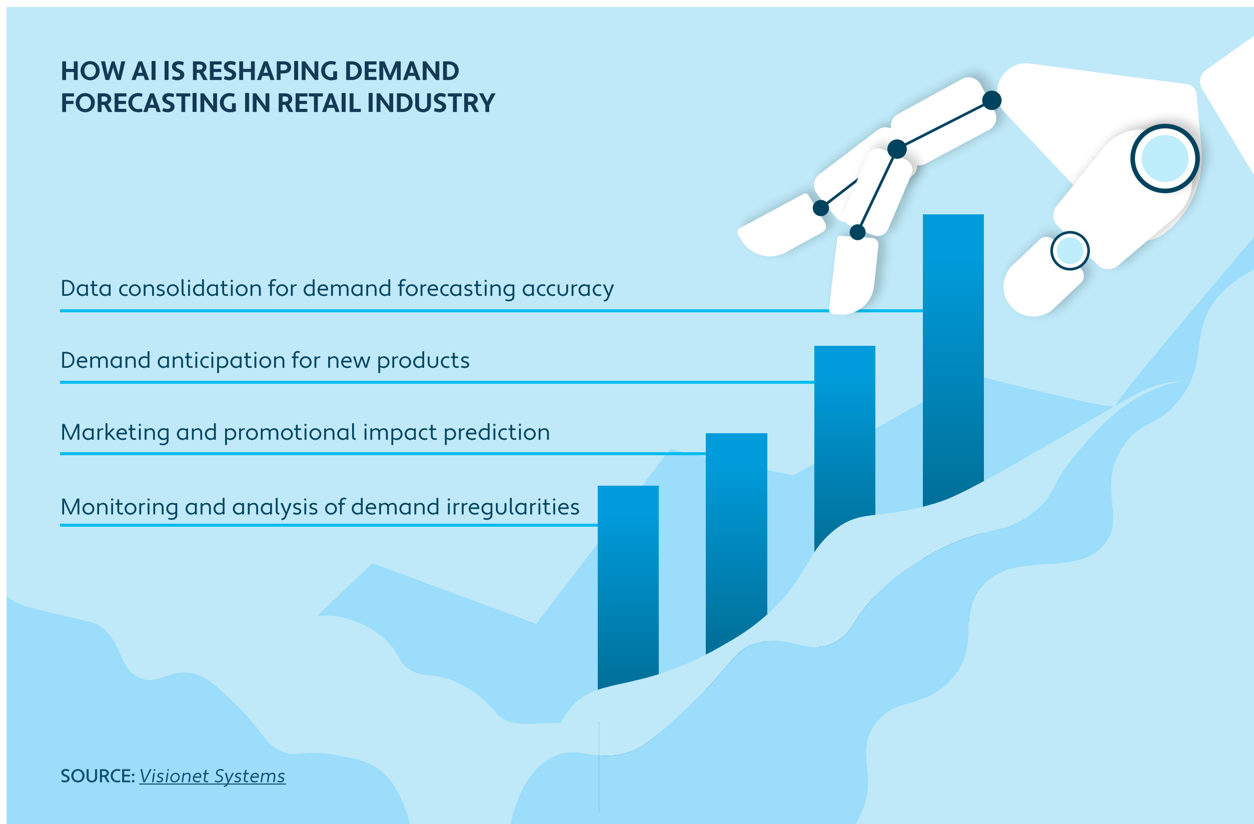
RETAIL

What else could affect the retail industry in 2024?

We'll likely see retailers use technology like AI to **streamline operations** in a variety of ways, including to:

- Anticipate demand
- Assess the success of marketing and promotional activities
- Consolidate data from multiple sources
- Identify experience **retail trends** (like those that erupted around the "Barbie" movie and Taylor Swift's Eras tour)
- **Forecast** the supply chain
- Reduce operational costs
- **Respond** to customer questions and concerns
- Automate markdowns and clearance processes
- Provide **personalized product** recommendations

Technology can help retailers determine the taxability of the products and services they sell as well. In fact, automation tools and AI are helping



state tax departments streamline processes and disseminate tax information to businesses.

For example, **Colorado** and **Missouri** are leveraging AI-driven Avalara Tax Research for Government to power their publicly available sales and use tax information, so retailers and other businesses can find data they need. The technology facilitates communication between state regulators and enables the states to easily keep track of ordinances, rules, taxability information, and proposed tax changes within their local jurisdictions.

"Using artificial intelligence, automation, and a team of tax experts, Avalara's solutions and database for tax compliance rates and rules help increase the accuracy and timely validation of tax data for businesses and governments alike," explains Jayme Fishman, EVP and GM of Indirect Tax at Avalara.

It's very difficult to meet the demands of sales tax compliance without relying on automation and other technology. There are too many nuances and too frequent changes to rates, rules, and regulations. What you're reading in this report gives a good idea of what's out there, but it certainly doesn't cover all tax changes. No one report could.

How Avalara can help

Avalara can help you account for tax changes and improve tax compliance for your business. Learn more about our automated solutions for calculating tax rates, preparing returns, and managing documents.

EXPLORE SOLUTIONS

Discover more tax changes in our other industry sections.

UP NEXT: SOFTWARE

Software

The next few years are likely to be big for the software industry, with artificial intelligence poised to accelerate software innovation. If history is to be repeated, new products and services will trigger new tax laws – and of course the policies will differ from state to state.

SOFTWARE

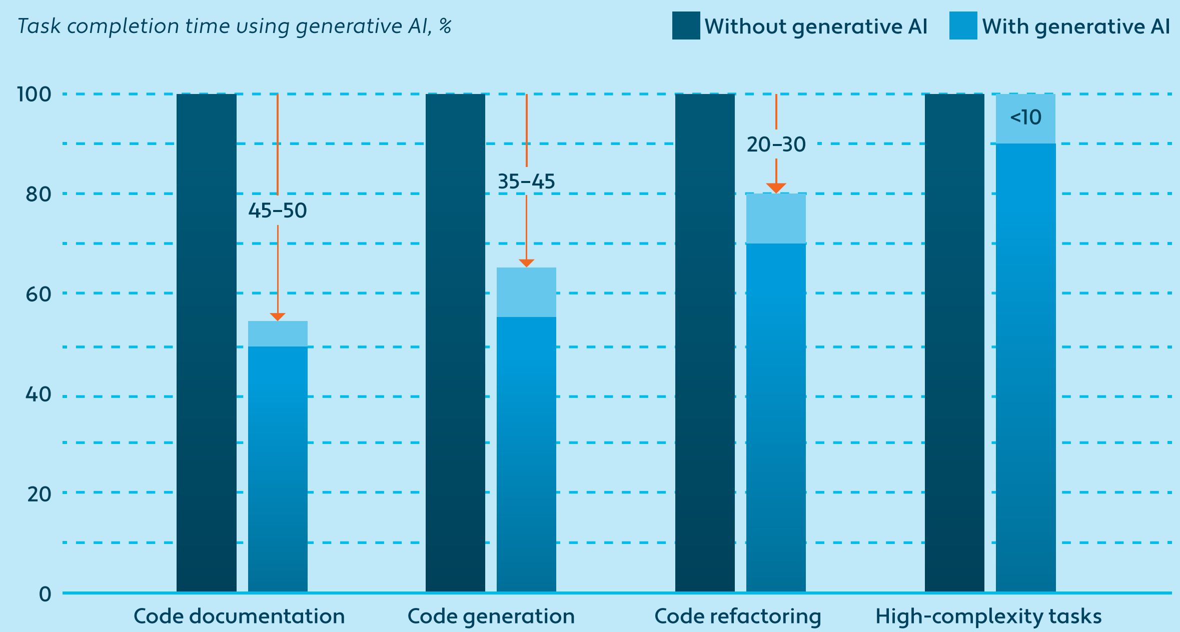
Tax changes for software, software services, and digital goods

We said it last year and we'll say it again now: The software industry is supremely positioned to take advantage of ongoing digital transformation.

Generative artificial intelligence (AI) has captured headlines since the launch of ChatGPT on November 30, 2022. Nearly every industry, from education and government to healthcare and marketing, is exploring how AI can improve and streamline operations. According to Boston Consulting Group, close to **80% of business leaders surveyed** say they're already using AI in some capacity.

Software developers themselves "can complete coding tasks up to twice as fast with generative AI," reports **McKinsey & Company**. AI particularly shines with "garden-variety tasks that software teams do regularly." The technology "significantly improves the developer experience, which in turn can help companies retain and excite their best talent."

GENERATIVE AI CAN INCREASE DEVELOPER SPEED, BUT LESS SO FOR COMPLEX TASKS



SOURCE: *McKinsey & Company*

This is good news. Though recent developments in AI have raised alarms about mass unemployment, many tech companies are struggling to find IT talent. More than **85 million jobs** globally – about the population of Germany – could go unfilled by 2030, according to a study by Korn Ferry. Unless more high-tech workers materialize by that date, the United States could miss out on $162 billion worth of revenue annually in tech alone.

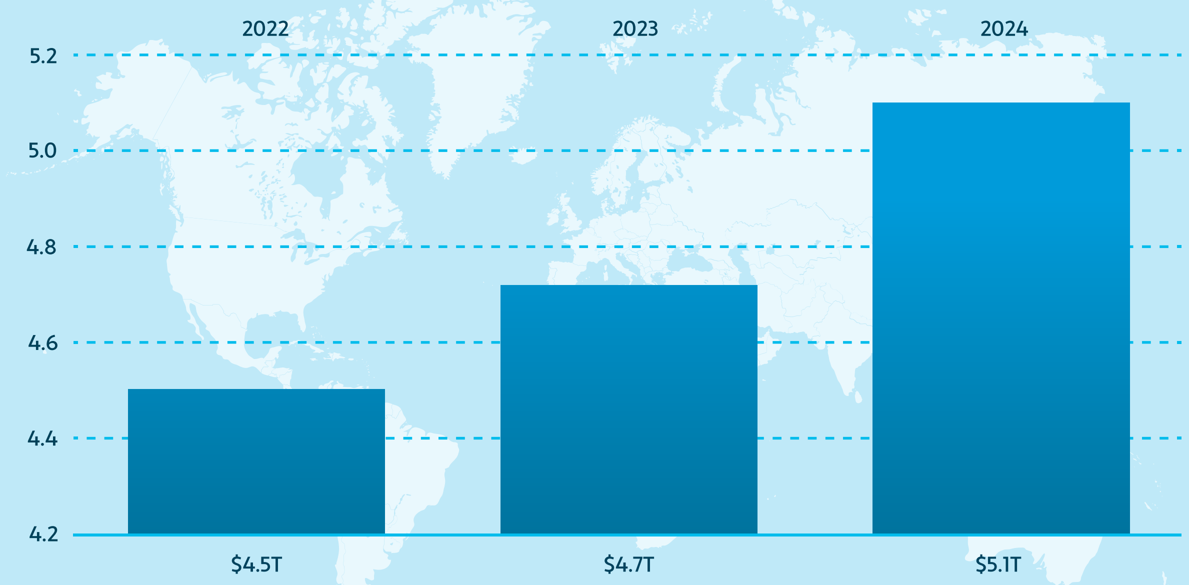
Generative AI hasn't significantly impacted IT spending as of July 2023, per **Gartner**, which expects worldwide IT spending to total $4.7 trillion in 2023. Businesses *are* spending more on software and IT services, but they're spending less on data center systems and devices. Many are reallocating software budgets to core applications and platforms that support automation and efficiency gains, like enterprise resource planning (ERP) and customer relationship management (CRM, applications). Indeed, IT accounted for 14.85% of **ERP users in 2020**.

Of course, AI technology isn't all peaches and cream. The McKinsey study found that some tasks took junior developers 7% to 10% longer with AI tools than without them, and the research suggests the tools are "only as good as the skills of the engineers using them." However, McKinsey believes a structured approach that includes generative AI training, workforce upskilling, and risk controls could lead to "extraordinary productivity and unparalleled software innovation."

But there's more to the software industry than AI. A host of companies are suiting up avatars and doing business in the metaverse, so inevitably, tax officials are starting to think about taxing transactions in virtual worlds. Governments are also getting a grip on digital currencies and non-fungible tokens (NFTs).

And, as always, policymakers are tweaking tax policies related to digital goods and services and software, and businesses are striving to be tax compliant.

WORLDWIDE IT SPENDING FORECAST



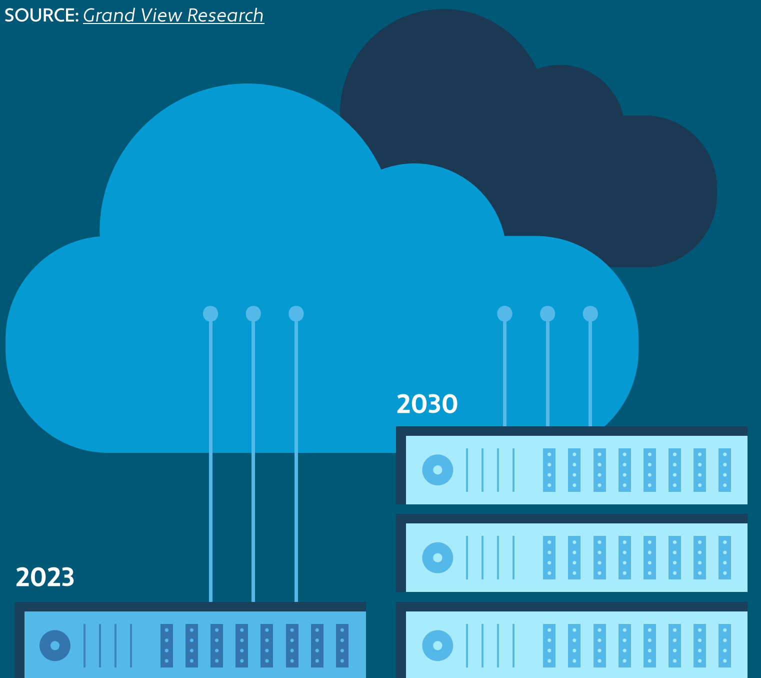
SOURCE: *Gartner*

Software

CLOUD COMPUTING MARKET

The global cloud computing market size was valued at $483.98 billion in 2022 and is expected to grow at a compound annual growth rate (CAGR) of 14.1% from 2023 to 2030

SOURCE: Grand View Research



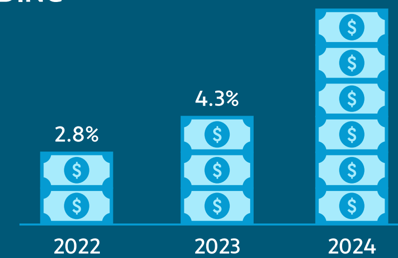
$484B
IN 2022

14.1% CAGR
2023–2030

WORLDWIDE IT SPENDING

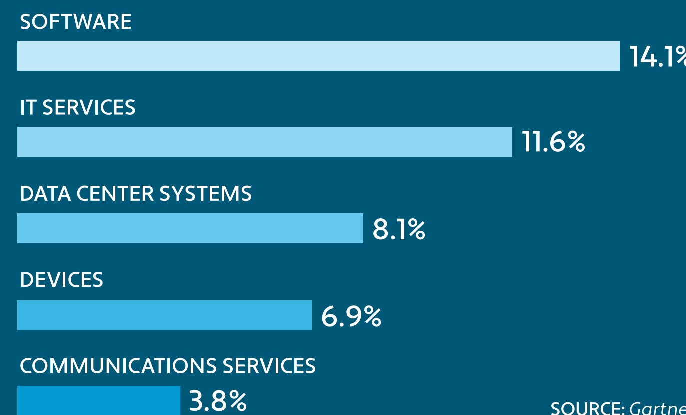
is forecast to grow

8.8% IN 2024



SOURCE: Gartner

WORLDWIDE IT GROWTH 2024 FORECAST



SOURCE: Gartner

69% of companies surveyed by Hanover Research and Avalara in 2023 are investing in new technologies to close efficiency gaps related to tax management

SOURCE: Avalara

75% of organizations surveyed are investing in new technology

50% are increasing their use of automation in response to economic concerns and other external factors

SOFTWARE

States tweak tax policies related to digital goods/services and software

This has got to be an exciting time for lawmakers and tax officials. Since the shape and tenor of sales tax laws were set long before the advent of digital goods and services, software, and virtual worlds, states have a lot to do to get sales tax laws up to date. After all, although the word "fungible" existed when Mississippi kicked off the U.S. sales tax trend back in 1930, "non-fungible tokens" have been a thing for less than 10 years (if indeed an NFT is a "thing").

"The digital world has created new products and marketplaces that include advertising, data usage, and ecommerce and now account for 3% of a consumer's spending, and this is increasing," notes the National Conference of State Legislatures (NCSL) in an overview of its **Indy 2023 Task Force on State and Local Taxation**. "With growing markets, states are enacting policy as well as encountering related legal challenges to new taxes."

That about sums it up.

Lots of states still don't tax digital products or streaming services, although most tax the underlying tangible products. For example, while a hardcover or paperback book is subject to sales and use tax in **California**, an ebook is not. The same goes for **West Virginia**. And the same goes for vinyl records or CDs (which are typically taxable in those two states) vs. digital music (which is generally exempt).

Sales tax revenue may not be suffering too much in states that don't tax many or most digital products and services, at least for now. **Sales tax collections** were surprisingly strong in a majority of states in August 2023, despite inflation, shaky consumer confidence, and the fact that state budgets are anticipating "**a slower economy**."

But that's likely to last only so long, as the percentage of a state's economy that's subject to sales tax is shrinking.

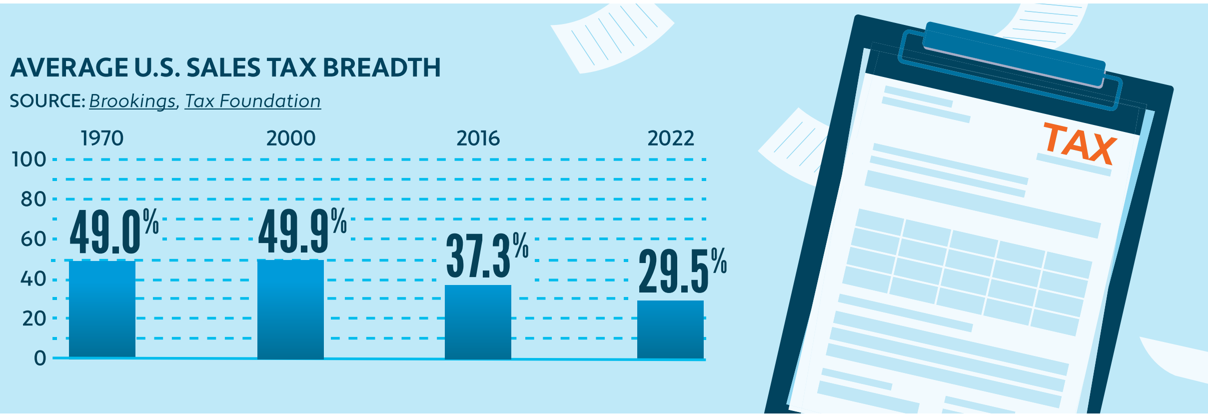
"The average sales tax breadth, or share of a state economy included in the sales tax base, was 29.71% in fiscal year 2021," observes the Tax Foundation, as reported by the **NCSL**. "This represents the lowest point in a consistent downward trend over the past several decades." If you're skeptical, consider this: The mean sales tax breadth in 1970 was 49%.

Rather than expand sales tax to more products and/or services, most states tend to raise sales tax rates when they need to increase collections. The median state sales tax rate in 1970 was 3.25%. Can you imagine? It jumped to 4% in 1980, 5% in 1990, and sits at 6% today.

There's another way: The **NCSL** and the **Tax Foundation** are in favor of broadening the sales tax base and, if possible, lowering sales tax rates – but taxing more products and services tends to be politically unpopular. "We're going to tax a lot more of your sales!" is not a favored line on the stump. And indeed, there were more new sales tax exemptions in 2023 than new sales taxes.

AVERAGE U.S. SALES TAX BREADTH

SOURCE: Brookings, Tax Foundation



David Lingerfelt, Senior Director of Indirect Tax at Avalara, says he doesn't see significant statutory developments on the 2024 horizon for software or digital goods, "but states may continue refining their positions on software and digital goods taxability through bulletins, notices, and court cases."

STATES WITH UPDATED SOFTWARE AND DIGITAL GOODS TAX POLICIES

A number of states did update sales tax policies related to certain digital goods and services, and/or software in 2023. Some new policies or clarifications came in the form of new laws, some in the form of rulings or guidance. These include, but certainly aren't limited to, the following:

The taxability of software in Mississippi depends on the location of the server. Senate Bill 2449 amended Mississippi sales and use tax law to address the taxation of computer software and computer software services in the state. As of July 1, 2023, remotely accessed software hosted on servers located outside of Mississippi is exempt from Mississippi sales and use tax. If the server is located in Mississippi, these transactions are subject to Mississippi sales tax.

Licenses to access cloud-based software are subject to Arizona TPT. Arizona courts have upheld the Arizona Department of Revenue's position on the taxability of software as a service (SaaS). Thus, licenses to access cloud-based software are considered **rentals of tangible personal property** and subject to Arizona transaction privilege tax (TPT).

Prewritten computer software is tangible personal property in Michigan. According to a **Revenue Administrative Bulletin** (RAB) issued by the Michigan Department of Treasury on July 31, 2023, prewritten computer software is considered tangible personal property and is subject to sales and use tax, whereas "software originally designed for the exclusive use and special needs of the purchaser" is exempt. The RAB is lengthy but distressingly short on "X is taxable, Y is exempt" statements.

MICHIGAN REVENUE ADMINISTRATIVE BULLETIN, JULY 2023

Prewritten computer software is not always purchased outright by a consumer, as it is common for a consumer to pay a fee for a license, subscription, or other right to use prewritten computer software instead. In those circumstances, the transaction would often be considered a taxable "use" of prewritten computer software … the Use Tax Act establishes that a "use" includes the "exercise of a right or power over tangible personal property incident to the ownership of that property …"*

*The key feature in determining whether a party exercises a right or power over tangible personal property is **"whether the party had some level of control over that property."**

SOURCE: *Michigan Department of Treasury*

Virginia's sales and use tax exemption for equipment purchased or leased for use in a data center applies to qualifying equipment first delivered to a storage facility. In June 2023, the Virginia Tax Commissioner ruled that equipment purchased or leased for use in a Virginia data center is exempt from Virginia sales and use tax "regardless of whether such equipment is delivered to a storage facility prior to delivery to the data center."

Remote personal electronic storage capacity services are not subject to the New Orleans French Quarter Economic Development District sales and use tax. The Louisiana Board of Tax Appeals ruled that sales of remote personal electronic storage capacity services are exempt from the New Orleans French Quarter Economic Development District sales and use tax (at least in this particular case); the federal Internet Tax Freedom Act (ITFA) prohibits state and local jurisdictions from taxing internet access, which includes personal electronic storage capacity provided independently or not packaged with internet access.

New York sales tax applies to a company's vendor management service. The New York Division of Tax Appeals determined a taxpayer's vendor management service was a taxable sale of prewritten software. New York Tax Law § 1105(a) imposes sales tax on the receipts from every "retail sale" of tangible personal property, which includes "prewritten computer software."

Kentucky sales tax applies to prewritten computer access services. "Prewritten computer software access services" are included in the list of warranty contracts subject to Kentucky sales and use tax as of January 1, 2023. Prior to that date, extended warranty service contracts that covered prewritten computer software access services (cloud-based software) were not subject to sales and use tax.

The enactment of HB 360 clarifies that Kentucky sales and use tax applies to charges to keep or retain prewritten computer access services in Kentucky (retroactive to January 1, 2023). It also specifies that a "use" does not include the keeping, retaining, or exercising any right/power over prewritten computer software access services purchased for use outside of Kentucky and transferred electronically outside Kentucky for use solely outside Kentucky.

Georgia taxes retail sales of specified digital products. As of January 1, 2024, specified digital products, other digital goods, or digital codes sold to an end user in Georgia are subject to Georgia sales and use tax provided the right of use is permanent.

SOFTWARE

(Re)defining digital codes

One of the most challenging aspects of taxing digital goods and services is that states don't necessarily define them the same way – or even at all – for sales and use tax purposes. The **Streamlined Sales Tax Governing Board** (SSTGB or simply SST) is working to rectify that, at least for its 24 member states. (SST was created to simplify sales tax administration for governments and reduce the burden of compliance for businesses.)

Under **Rule 332 of the SST Rules and Procedures**, approved October 2005 and most recently amended October 2021, specified digital products include digital audiovisual works, digital audio works, and digital books. Member states are free to tax or exempt all or some of these products as they see fit, as long as they use the same definition for specified digital products, digital audiovisual works, digital audio works, and digital books.

Section 332.G specifies that the tax treatment of a "digital code" be the same as the tax treatment of the specified digital product to which the code relates; you basically look through the code to the underlying specified product. SST defines digital code as "a code that provides a purchaser with a right to obtain one or more digital product(s) within one or more of the 'specified digital product' subcategories having the same tax treatment." A digital code may be transferred electronically or via a tangible medium, such as a card, invoice, or gift certificate.

As noted, this is how SST defined digital code and specified digital products in October 2021. That was just a few months after the first NFT artwork sold for over $69 million. ***Everydays: The First 5000 Days* by Beeple** wasn't the first NFT – many consider that to be **Kevin McCoy's *Quantum***, which was minted in 2014 – but it definitely caught the attention of tax policymakers.

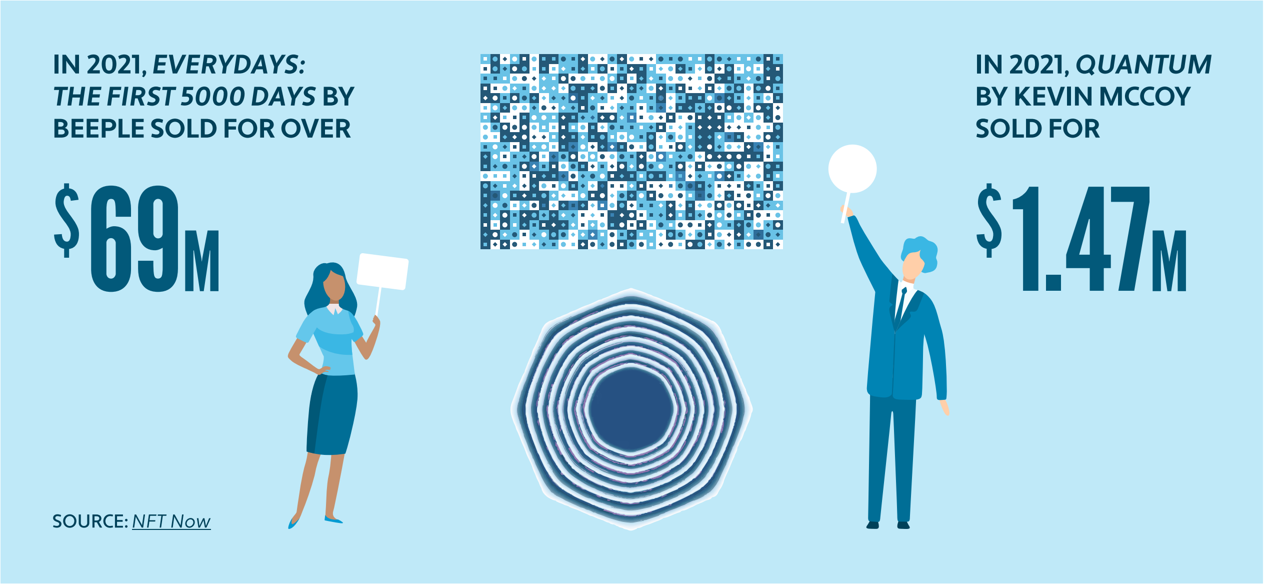
Because NFTs were so new in 2021, they **weren't addressed in any state's sales and use tax laws** when that $69 million sale occurred. Not directly, at any rate. As a result, at least one state probably missed out on a whole heap of sales or use tax revenue.

"Commerce will always evolve faster than tax policy," notes David Lingerfelt. "It is typically a trigger event, such as significant revenue seepage over multiple budget cycles or a high-dollar sale highlighted in the news, that gets the attention of policymakers."

So, SST is developing a **new definition for "digital code**." It's very meta: "'Digital code' means an alphanumeric or graphic code, which provides a purchaser with an object to obtain a 'digital code object.'" It also includes "a code provided to purchasers in the form of an electronic instrument that is capable of being scanned from the purchaser's electronic device." One pictures a QR code.

As proposed, "digital code object" includes:

- A specified digital product
- A product transferred electronically
- Prewritten software delivered electronically
- Access to a digital computing environment or physical venue
- Evidence of ownership of property



- Object to obtain the performance of a service or any other object afforded the possessor of the digital code, regardless whether such property or service is capable of electronic transfer or delivery

The proposed update to the digital code section further specifies that "tax rules applicable to sales of digital codes apply "regardless of the nomenclature used to describe the code including its characterization as a non-fungible token and regardless of the technology used to generate the code, including blockchain technology."

In other words, SST is trying to cover all the bases. All the bases it knows about today, at least.

SST's **State and Local Advisory Council** also recommends moving the time of tax collection up from the time the *product* is delivered (when no money changes hands and there's little to no opportunity for the seller to collect tax) to the time the *digital code* is delivered. And it would like to expand the digital codes look-through rule beyond specified digital products to sales of digital codes for software delivered electronically and to codes delivered using NFTs that result in the transfer of other types of products.

Because it *is* possible to purchase an **NFT that provides membership to an exclusive real-world club** where you can eat real food and drink real drinks, and the like.

SOFTWARE

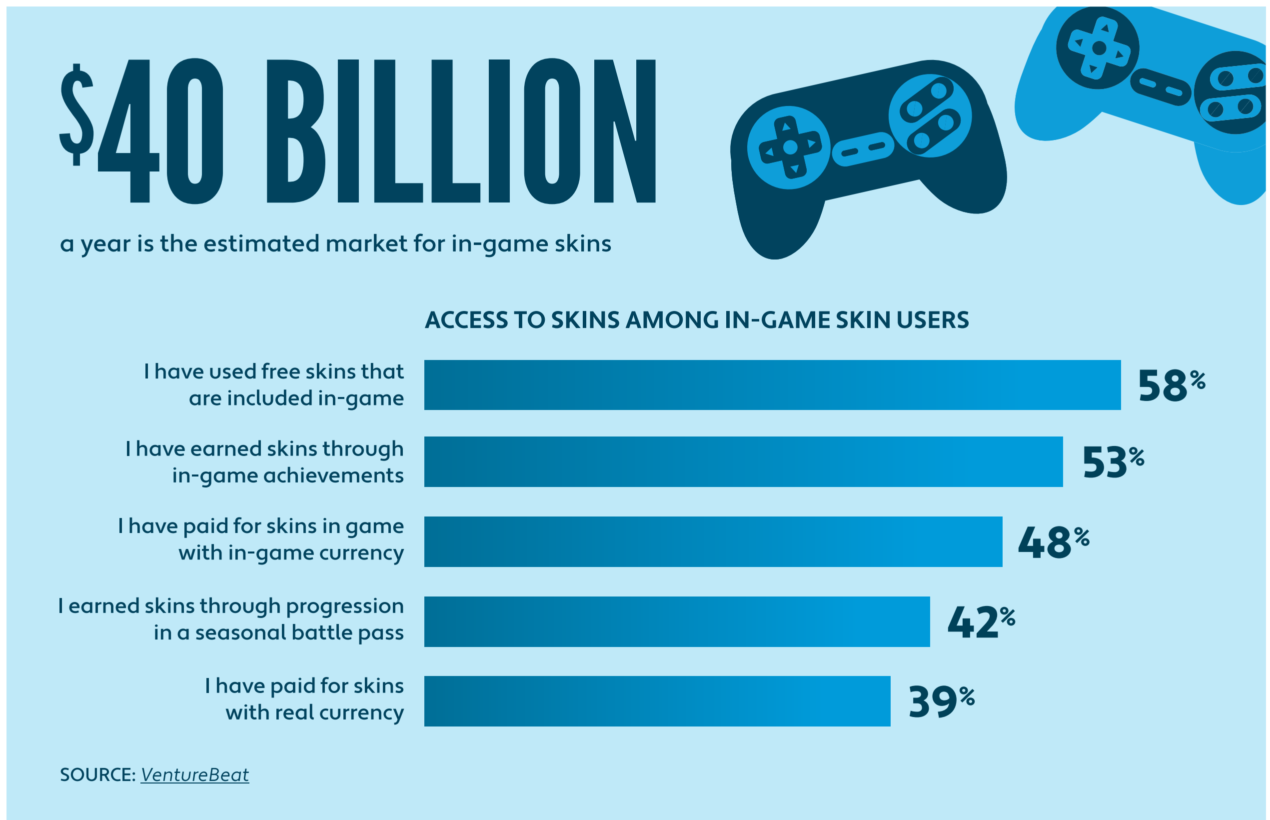
Bridging – and taxing – the virtual and physical

SST is to be applauded for tackling this issue. “Most tax authorities and policymakers don’t really get the metaverse,” says David Lingerfelt. “They don’t understand the issues triggered by the metaverse. Whoever would have imagined that you would buy a digital pair of shoes to put on a digital representation of yourself?” Or better yet, that you’d want your real body to have a matching pair?

Tax authorities may not get it, but businesses sure do.

Holders of the Adidas **Into the Metaverse NFT**, created in December 2021, were **guaranteed access to exclusive physical products** through 2022. You can collect virtual Jibbitz charms and win yourself physical charms in the **Crocs virtual Jibbitz store**. And the first label to launch on **SYKY**, a community-driven fashion platform, included a **1:1 digital and physical handbag** – a 3D-printed, resin-and-electroplated collectible with a digital twin.

There’s real money at stake. The market for in-game skins (clothing and such for avatars)



is worth an estimated **$40 billion**, and virtual products can **drive demand for counterpart products** in the real world.

And this isn't just happening with intangible and tangible *things*: The **audience for virtual concerts is growing**. Three out of four people attended an online event during the pandemic, according to a survey of 1,000 consumers, and **88% of those who did said they would do so again** once in-person gatherings returned. And why not? You don't have to deal with crowds, or parking, and the price of admission is often much less.

HOW DO YOU TAX TRANSACTIONS IN THE METAVERSE?

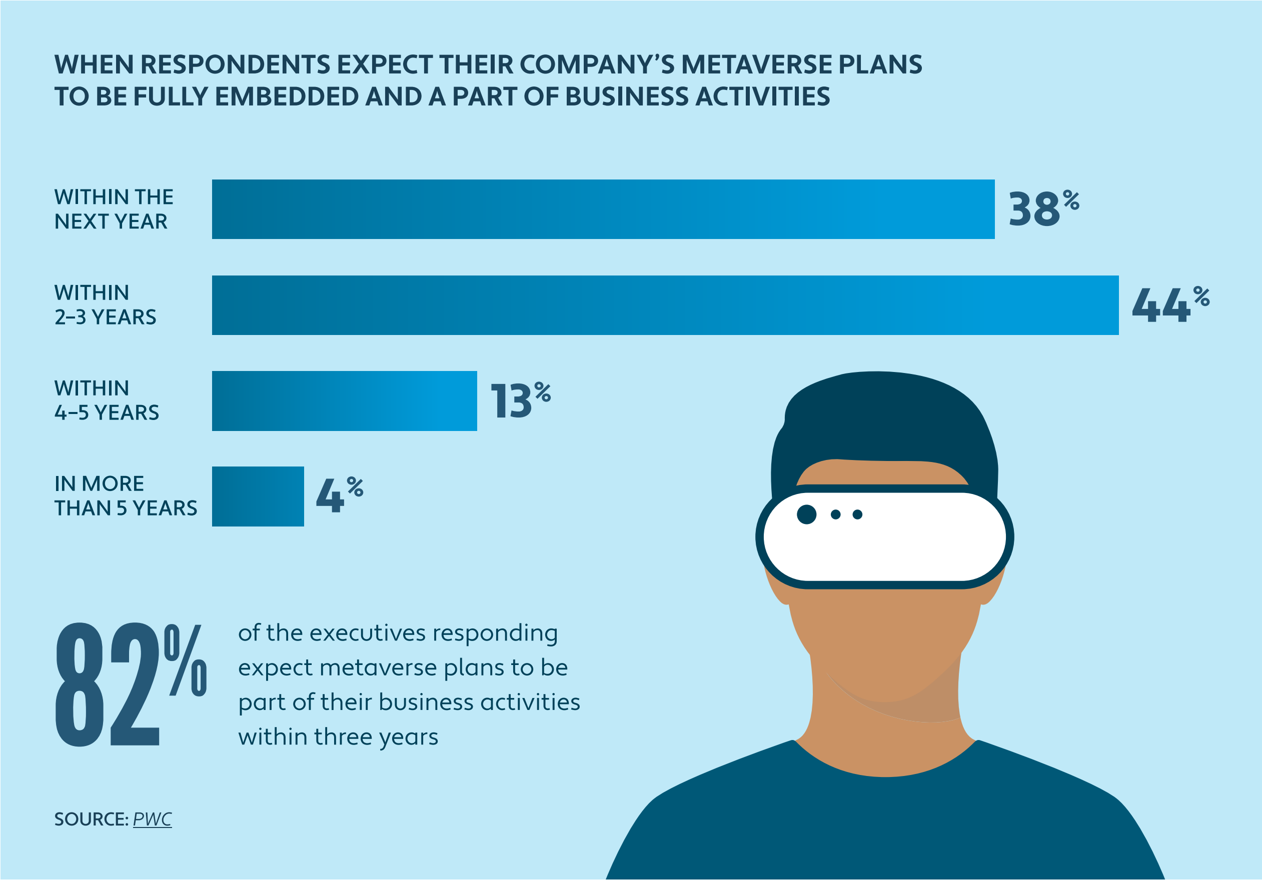
So what does all this mean for sales tax and admissions tax? Should sales tax apply when you buy a sweatshirt for your avatar and for your real body? If so, at what point? Does the admissions tax you paid for a nosebleed seat at a Taylor Swift concert apply to your virtual **chamber music** subscription?

Well, tax authorities are still sorting that out.

"Some state legislation governing admissions tax is broad, so you could argue it applies to a virtual event," says Lingerfelt. "But you can drive a bus through broad. People will argue that the original admissions tax law was not intended to apply to a virtual event."

Some of the **questions that need to be addressed** in order to properly tax transactions in a virtual world include:

- **What was sold?** A digital product? A digital service? Neither? Both? What about if the sale of an NFT results in the purchase of a physical product or real-world experience?
- **Who sold it?** Many virtual worlds essentially function as marketplaces, and in another "meta" move, there can be **secondary marketplaces** within them. Should marketplace facilitator laws apply?
- **Who has jurisdiction over the transactions?** Is it the location of the server? The operator of the platform? The buyer? What if you don't know who or where the seller or buyer is?
- **What's the sales price?** If cryptocurrency was used to make a purchase, should tax be based on the date-of-sale value or the time-of-sale value?
- **What are the rules?** Are they set? In flux?



SST and the **Multistate Tax Commission** are working on this, as are tax officials in some individual states. But this is uncharted territory, so it's slow going. State officials are wary of making a new rule, policy, or law that could end up leading to a lot of litigation.

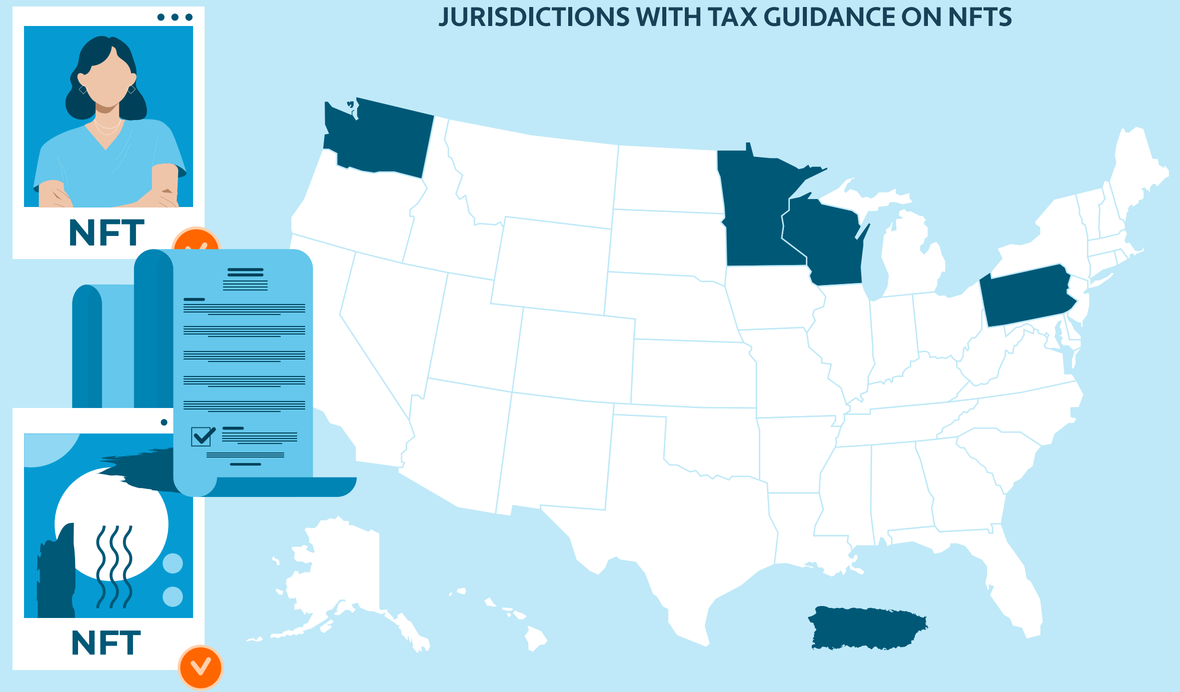
HOW DO YOU TAX NFTS?

To date, only about five U.S. jurisdictions have issued guidance on **taxing NFTs**:

- Minnesota
- Pennsylvania
- Puerto Rico
- Washington
- Wisconsin

David Lingerfelt is hoping more states will address NFTs in 2024. Whether any actually will remains to be seen, but the issue is getting attention in some **other countries**. For example, **Italy** has proposed exempting an NFT from value-added tax (VAT) if all the NFT rights are assigned by its original artist. And the European Commission's Value Added Tax Committee mentioned dynamic NFTs in a **working paper** published February 2023; the paper summarizes how Belgium, Norway, and Spain have answered questions related to the taxation of NFTs.

JURISDICTIONS WITH TAX GUIDANCE ON NFTS



SOURCE: *Avalara*

SOFTWARE

That darn digital ad tax

Maryland's digital advertising tax was vetoed, challenged in state and federal courts, dismissed by the federal court, ruled unconstitutional by the circuit court, and allowed to stand by the Maryland Supreme Court. Through it all, the state (if not all tax officials in the state) has steadfastly defended its right to collect the **digital advertising gross revenues tax**. The tax had reportedly generated more than **$106 million** in revenue as of May 2023. (Do you think that covered the legal fees?)

The Maryland Supreme Court overturned the lower court's ruling on the grounds that it lacked jurisdiction. It didn't address the constitutionality of the tax, so we're basically back to where we started. We probably haven't seen the last of the legal battles, and we probably won't in 2024, says David Lingerfelt. "It will trudge along."

Meanwhile, states interested in establishing similar digital ad taxes may be emboldened to move forward. As they look to tax digital advertising, observes **Toby Bargar**, Senior Tax Strategist at Avalara, they'll have to take into account some of the key aspects of the Maryland case.

To wit, the District of Columbia Tax Revision Commission met in September 2023 to discuss **various tax proposals**, including to **strengthen and clarify taxation of digital ads and services**. The Commission will deliberate the proposals, consider public comments, and submit a final set of recommendations to the D.C. Council at the end of 2024.

D.C. isn't alone, although the Council On State Taxation generally considers state digital services taxes to be "**a bad idea under any theory**":

- States that have considered some sort of digital advertising gross receipts tax include **Connecticut**, **Massachusetts**, **Montana**, **New York**, and **Texas**
- States interested in digital ad taxes on social media transactions include **Arkansas**, **Connecticut**, and **Indiana**
- States interested in taxing data mining, personal information, and/or sales of personal data include **Massachusetts, New York**, **Oregon**, **Washington**, and **West Virginia**

New Jersey is also studying these taxes, though it hasn't yet gone so far as to introduce them. And **New Mexico** is working to clarify that its tax on advertising services applies to digital ads despite the fact that the law predates digital ads.

SOFTWARE

Digital ad taxes highlight sourcing challenges

In October 2023, the New Mexico Taxation and Revenue Department issued **proposed rule amendments** that detail which receipts from the sale of digital advertising services are subject to gross receipts taxation and which are deductible. It also clarified the sourcing rules for such receipts. The tax department did more or less the same thing in 2022, but pulled the proposed regulations after hearing taxpayers' concerns.

This 2023 proposal addresses many of those issues, including sourcing methodology. It proposes changing the source of digital advertising receipts from the location of the server to the location of the digital platform company where the advertisement is viewed or accessed.

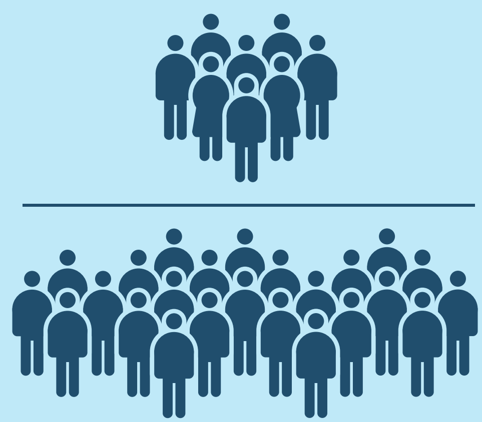
It can be difficult to accurately source digital sales or digital advertising, which may not be considered a digital good for tax purposes. For starters, many states don't provide adequate guidance. Even if there is proper guidance, the seller may not know where a digital good was received or used, or how many people inside a state saw a digital ad. The location of the purchaser may not be known, or there may be multiple locations or multiple points of use (when digital goods, computer software, or services are concurrently available for use in more than one jurisdiction, or a digital ad appears on devices up and down the East Coast).

For instance, businesses purchasing digital products that may be used concurrently within and outside Washington are entitled to the **multiple points of use sales tax exemption**. The buyers must provide the exemption certificate and pay use tax based on the following equation: Divide the number of users (e.g., employees or agents) in Washington by the number of users everywhere.

PURCHASING DIGITAL PRODUCTS FOR USE WITHIN AND OUTSIDE WASHINGTON

Businesses purchasing digital products that may be used concurrently within and outside the state are entitled to the multiple points of use (MPU) sales tax exemption. The buyer must provide the exemption certificate and pay apportioned use tax.

To calculate the apportioned value owed, the buyer divides the number of users in Washington by the number of users everywhere.



SOURCE: *Washington State Department of Revenue*

Digital sales are generally sourced to one of the following:

- Destination of the product (usually for digital goods classified as tangible personal property)
- Destination of the person who benefits (usually for digital goods classified as a service)
- Billing address

Alternatively, the taxing authority may look at the multi-state benefit – though this approach comes with challenges. How exactly do you source the sale of digital goods or services between multiple states? Do you base tax on the actual usage or expected usage (and how can you tell)? Do you base it on the value of the usage? Something else?

Unfortunately, businesses often don't obtain the buyer's full address for remote sales of digital goods or services. If the transaction involves an NFT or cryptocurrency, there may be no physical address at all. This is an issue SST member states and the SST Business Advisory Council have been chewing on for years.

SST CERTIFIED SERVICE PROVIDERS PROPOSE SOURCING RULE CHANGE

In September 2023, the National Association of Certified Service Providers (NACSP) suggested **revising the Streamlined Sales and Use Tax Agreement** to address this issue. Though they believe the current sourcing provisions have generally worked well and should be "retained to the maximum extent feasible," they "recognize there are differences in interpretation that could be clarified."

Under the **existing SST sourcing provisions**, a seller is required to use delivery information "known to the seller," "available from the business records of the seller that are maintained in the ordinary course of the seller's business," or "obtained during the consummation of the sale, including the address of a purchaser's payment instrument." If those rules can't be applied, sales are sourced to the point of origin.

Certified Service Providers (CSPs) understand states have legitimate concerns with origin sourcing, including that origin sourcing could incentivize companies to move operations offshore or to non-sales-tax states. Accordingly, they propose adding two new sections, Section 310(A)(6) and Section 310(A)(7).

Section 310(A)(6) would read: "Except as set forth in Section 310(A)(7), nothing in this Section places an affirmative duty on a seller to obtain a delivery address under Section 310(A)(2), a purchaser address under Section 310(A)(3), or address information not necessary to complete the sale under Section 310(A)(4)."

Section 310(A)(7) would read: Notwithstanding Section 309 and Section 310(A)(6), a seller shall be considered to have collected the correct amount of state and local tax on a sale if the seller:

1. Sourced the sale using Section 310(A)(5),
2. Has not obtained either a street address, a 5-digit ZIP code, or a 9-digit ZIP code from the customer, and
3. Requested but did not obtain a street address, a 5-digit ZIP code, or a 9-digit ZIP code from the customer.

A seller will be deemed to have requested such information if it provides a prominently displayed location, on its ordering page or other equivalent documentation, specifically designed and designated for such information. "The seller may not state that the information is 'optional.' On the other hand, the seller is not required to state that the information is 'mandatory.' The seller is not required to reject the transaction if the information is not provided by the customer."

These are ideas. Whether SST will adopt them as a best practice is unknown at this time.

SOFTWARE

What else could affect the software industry in 2024?

THE OECD IS GETTING CLOSER TO BANNING DIGITAL SERVICES TAXES

The Organisation for Economic Co-operation and Development (OECD) is **opposed to digital services taxes**, and that's taken some of the steam out of digital services taxes in other countries. In July 2023, the 138 countries and jurisdictions that have agreed to reform international taxation rules also agreed **to refrain from imposing newly enacted digital services taxes** or relevant similar measures on any company before December 31, 2024.

Nevertheless, **Canada** intends to levy a new digital services tax on January 1, 2024.

In October 2023, the OECD released the text of a new multilateral convention that will **update the international tax framework** and remove digital services taxes if ratified. Ratification in the U.S. could be difficult. For one, it requires a two-thirds majority in the Senate. For two, it would subject large multinational corporations – including American companies – to an effective tax rate of 15% of their profits in every jurisdiction where they operate.

TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALIZATION OF THE ECONOMY

138 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) – representing over 90% of global GDP – agreed to **refrain from imposing newly enacted digital services taxes or relevant similar measures on any company** before December 31, 2024.

This "will provide stability for the international tax system, making it fairer and work better in an increasingly digitalized and globalized world economy."

SOURCE: *OECD*

Whatever happens with OECD's plan may or may not influence states that are considering some type of tax on digital services, such as advertising.

STATES ARE REEVALUATING ONLINE LEARNING

Taking a lesson from the pandemic, states turned their attention to the taxability of online training and education. "There were no major statutory developments," says David Lingerfelt, "but some states issued guidance to clarify how online training and education is taxed under current law."

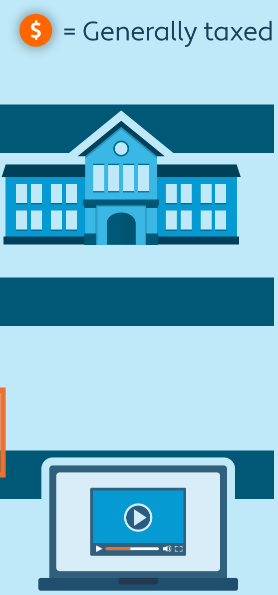
The general rule of thumb is that education for academic credit, whether a class is online or in person, isn't subject to tax. If it's not for academic credit, the deciding factor is often whether the instruction is live, interactive, or prerecorded. The more interaction a student has with a teacher, the less likely charges for instruction are to be taxed.

The type of institution selling the online education also matters. While education taught by nonprofit or government institutions is exempt in many states, education taught by for-profit institutions doesn't benefit from these exemptions.

That's far from everything, but we have to draw the line somewhere.

TAXABILITY OF ONLINE TRAINING AND EDUCATION

SOURCE: *Avalara*



How Avalara can help

Avalara can help you account for tax changes and improve tax compliance for your business. Learn more about Avalara's cloud-native tax compliance solution for software and SaaS businesses, including tax rate calculation, returns preparation, and document management.

EXPLORE SOLUTIONS

Discover more tax changes in our other industry sections.

UP NEXT: MANUFACTURING

Manufacturing

What does the factory of the future look like? Embedded technology and the availability of data are enabling Industry 4.0, a high-tech fourth industrial revolution. But a worker shortage is still impacting operations, influencing companies to reimagine the way people work and consider reskilling their current employees. And companies are finding ways to mitigate the effects of supply chain disruptions caused by strikes, layoffs, geopolitical events, and extreme weather. And of course, industry changes beget tax changes (and sometimes vice versa).

Manufacturing

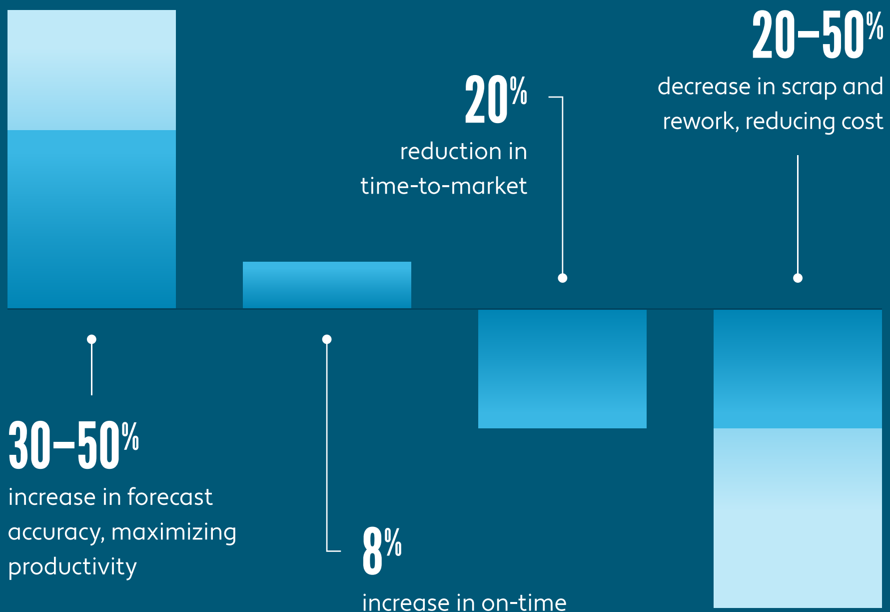
EXEMPTION CERTIFICATES

53% of companies surveyed still handle exemption certificates manually or mostly manually

SOURCE: Avalara

3% of accounting, finance, and tax professionals surveyed have fully automated their process

BENEFITS OF A DIGITAL SUPPLY CHAIN WITH REAL-TIME VISIBILITY



30–50% increase in forecast accuracy, maximizing productivity

8% increase in on-time delivery, improving customer satisfaction

20% reduction in time-to-market

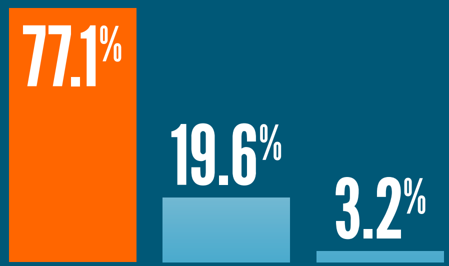
20–50% decrease in scrap and rework, reducing cost

SOURCE: Oracle

LITTLE LETUP IN CROSS-BORDER ECOMMERCE GROWTH

More than 75% of companies surveyed in our state of cross-border ecommerce report expect cross-border ecommerce to grow over the next 24 months

SOURCE: Avalara



2.1M UNFILLED JOBS by 2030 due to the manufacturing skills gap in the U.S.

$1T BY 2030 ALONE is the potential cost as a result of those unfilled jobs

SOURCE: Deloitte

MANUFACTURING

The digitalization of manufacturing

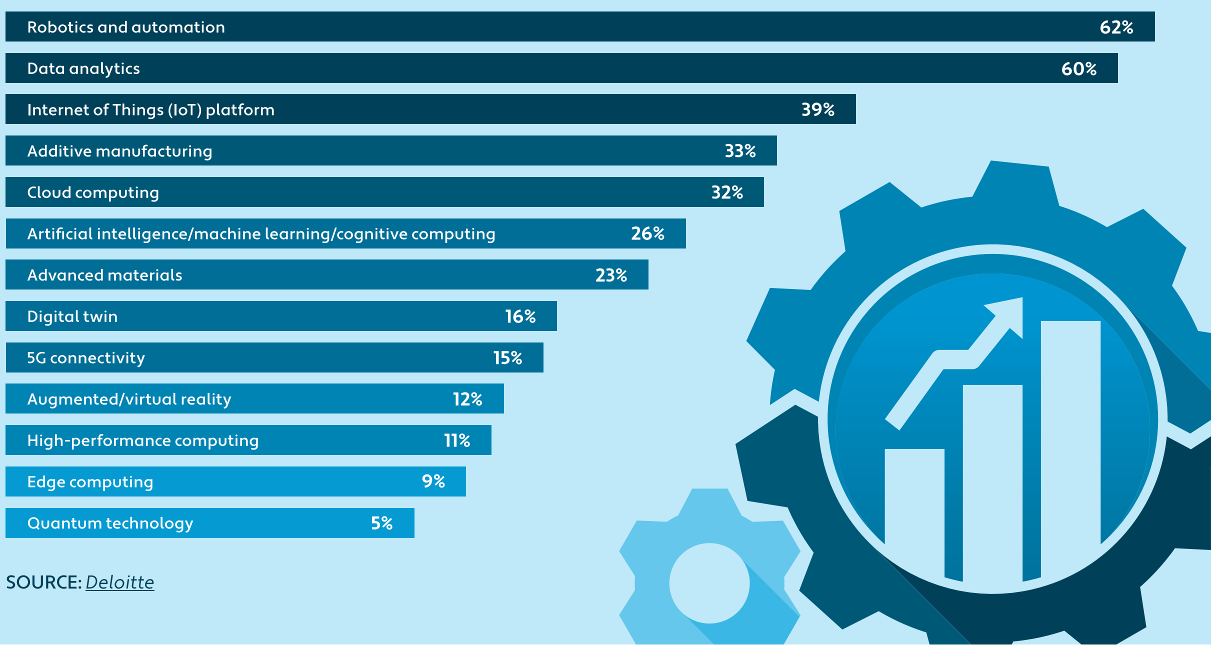
Like many industries, the manufacturing industry is turning to technology to stay competitive and overcome challenges. While it’s tempting to imagine a bunch of Roseys from “The Jetsons” or Benders from “Futurama” assembling cars and operating machine presses, the approach is more high tech than high mech.

According to the **Deloitte 2023 manufacturing industry outlook**, 62% of manufacturers surveyed are investing in robotics and automation to speed manufacturing, reduce costs, and alleviate pain caused by labor shortages; 60% are looking to data analytics to improve forecasting and spot supply chain shortages before they affect production; and 39% are using the Internet of Things (IoT) to collect and analyze data from sensors on the factory floor and embedded in industrial equipment to improve manufacturing, supply chain training, and product maintenance.

Of those surveyed by Panorama Consulting Group in 2020, manufacturers were also the **main users of ERP systems** at 33.66%. In fact, according to

INVESTING IN ADVANCED TECHNOLOGIES

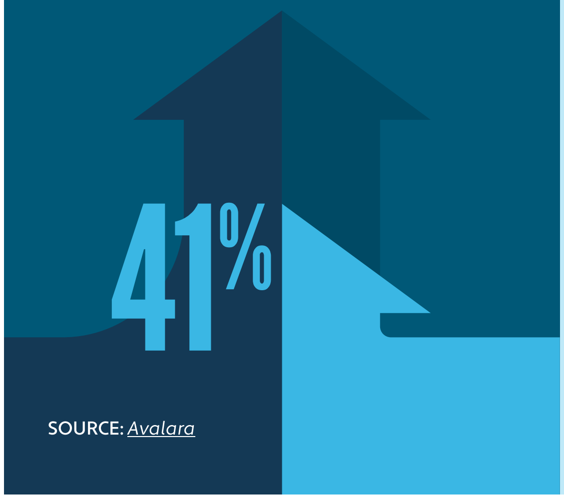
Surveyed manufacturers plan to focus on a range of technologies to increase operational efficiencies over next 12 months



SOURCE: *Deloitte*

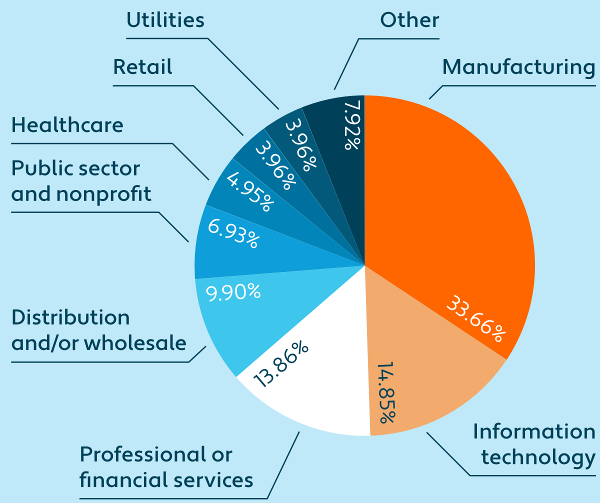
TAX COMPLIANCE PRIORITIES

Streamlining the tax compliance process by integrating tax compliance technologies with existing financial systems infrastructure (such as an ERP) is the top priority of respondents from U.S. manufacturing companies at 41%



SOURCE: *Avalara*

MAIN ENTERPRISE RESOURCE PLANNING (ERP) USERS



SOURCE: *Panorama Consulting Group*

respondents of an Avalara and IndustryWeek survey, a big **tax compliance priority for manufacturers** is for their technology to integrate with existing ERPs and other systems.

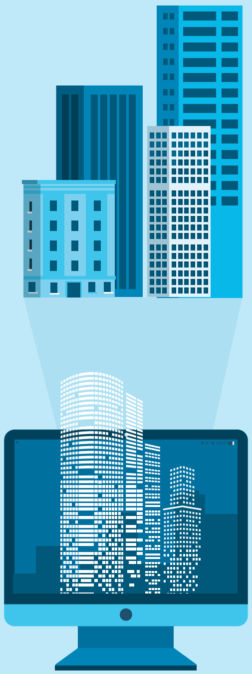
Research found that those manufacturers who have adopted emerging technology are more agile than those who have not; they are able to pivot if the industry calls for a change, and they have increased supply chain visibility and can better adapt to supply chain challenges (something we have become acutely aware of in the last few years).

THE INDUSTRIAL REVOLUTION GOES HIGH TECH: INDUSTRY 4.0

Are technological advancements in manufacturing ushering in another industrial revolution? While previous revolutions in manufacturing have been characterized by steam, electricity, and computers, the era we're currently experiencing is all about smart technology. **Industry 4.0** (the high tech-sounding name for the fourth industrial revolution) is driven by the Internet of Things, cloud computing, artificial intelligence and machine learning, edge computing, cybersecurity, and digital twins.

THE MICROFACTORY: SMALLER AND BETTER THAN EVER?

Maybe bigger isn't always better when it comes to manufacturing. Integrated technology and digital transformation have created the perfect opportunity for the **resurgence of the microfactory**, a small, modular, technologically advanced manufacturing facility. These structures can be set up near customers to reduce shipping and storage costs.



WHAT IS A DIGITAL TWIN?

A digital twin is a virtual replica of a physical object or system, equipped with sensors and connected to the internet that can collect data and provide real-time performance insights.

PROJECTS THAT BENEFIT FROM THE USE OF DIGITAL TWINS:

- **Physically large projects:** Buildings, bridges, and complex structures
- **Mechanically complex projects:** Jet turbines, automobiles, and aircraft
- **Power equipment:** Mechanisms that generate and transmit power
- **Manufacturing projects:** Streamlining process efficiency found in industrial environments

SOURCE: *IBM*

FACTORY SIMULATORS: DIGITAL TWINS

What if you could put those hours spent playing RollerCoaster Tycoon, Factorio, or any number of logistics and resource management video games to good use? **Some manufacturers have started using digital twins** – virtual models of a physical object – to revolutionize operations. Smart factories are equipped with sensors that relay data and performance insights, and the virtual model can be used to run simulations, test out new processes, and study performance issues before solutions are applied to the physical factory.

ARTIFICIAL INTELLIGENCE FOR REAL-LIFE RESULTS

From writing high school term papers to imagining a full landscape behind the "Mona Lisa," people are using artificial intelligence (AI) everywhere. So how are manufacturers making it work for them? AI's ability to analyze huge amounts of data can come in handy when Industrial Internet of Things (IIoT) sensors are collecting and sending data from machines and equipment, making it easier to identify trends and catch problems earlier.

Speaking of catching problems earlier, wouldn't it be nice to know ahead of time – based on real-time data – when a belt should be changed or a die needs to be sharpened? AI can help manufacturers put **predictive maintenance** systems in place and proactively address workplace safety hazards.

Tax officials have also started **relying on AI** and other new technology to uncover noncompliant businesses. Experts in data science and tax enforcement have partnered to apply machine-learning technology to identify areas of potential compliance risk. Similarly, businesses can use the same type of technology to help ensure they remain in compliance and competitive. An increasing number of businesses are turning to tax automation software to reduce the burden of managing sales tax and exemption certificates on their own. More on that later.

MANUFACTURING

The new age of manufacturing employees

Even though the digitalization of the industry is changing the types of skills needed in manufacturing, workers are still needed – and businesses are finding good help hard to come by. According to the **2023 Manufacturing Industry Outlook**, there was a record high of roughly 800,000 unfilled manufacturing jobs across the U.S. in 2022.

EMPLOYEE ATTRACTION AND RETENTION

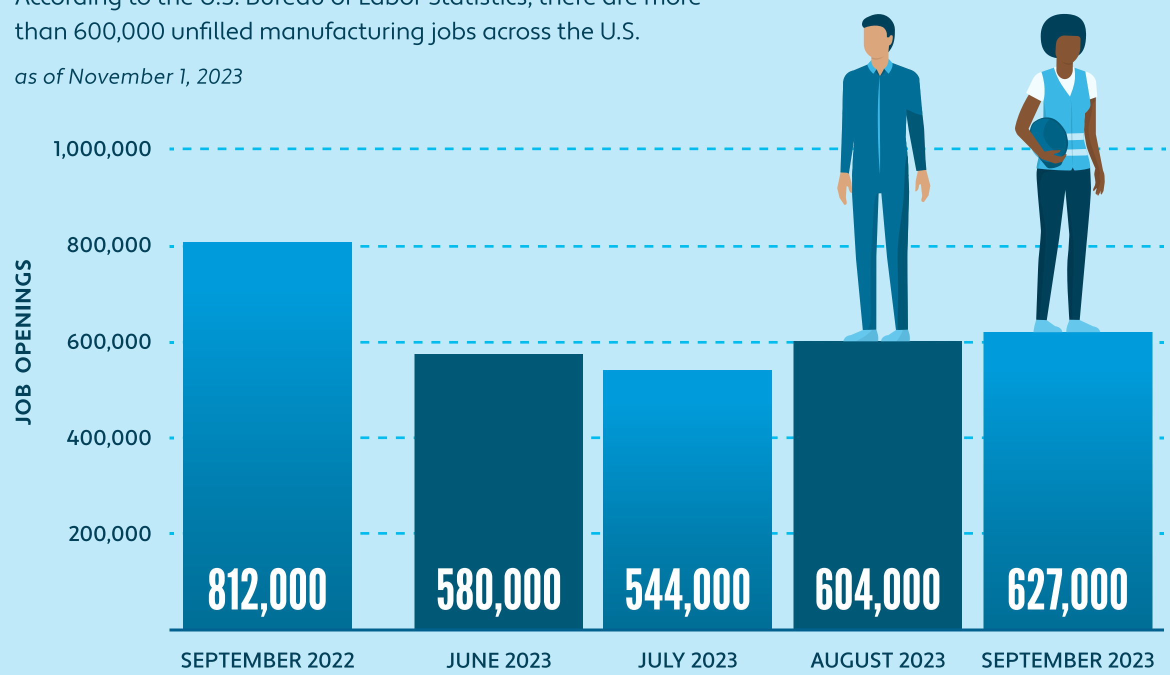
Attracting and retaining talent will remain a top priority for many manufacturers in the next year. Manufacturers are considering raising wages; investing in startups or collaborating with academic ecosystems to gain access to new technology and talent; focusing on diversity, equity, and inclusion initiatives to attract more women and racially and ethnically diverse workers to the industry; and exploring ways to make the workplace more flexible. Another way manufacturers can address the labor shortage and prepare to meet the changing skills needs of the industry is by **upskilling their current workforce** and giving employees the technical and digital training needed to work with new systems.

JOB OPENINGS IN MANUFACTURING

SOURCE: *BLS*

According to the U.S. Bureau of Labor Statistics, there are more than 600,000 unfilled manufacturing jobs across the U.S.

as of November 1, 2023



MANUFACTURING

Keeping manufacturing close to home

There's no place like home. At least that's what many manufacturers are finding as it relates to reshoring their operations. The Biden administration is rewarding manufacturers that keep operations in the United States too; the Inflation Reduction Act establishes tax incentives and policies for businesses to manufacture in the United States, the **CHIPS and Science Act** sets aside $50 billion for the domestic semiconductor industry, and the Infrastructure Investment and Jobs Act allocates $1.2 trillion for transportation and infrastructure.

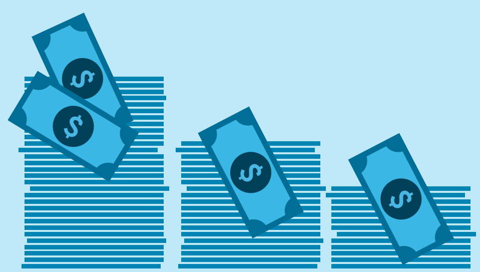
Then there's the added benefit of being that much closer to your suppliers. According to **recent supply chain research**, 80% of surveyed manufacturing executives experienced a "heavy" to "very heavy" impact of disruption on their supply chains over the last year and a half. So executives hoping to mitigate supply chain disruptions, reduce transportation costs, and increase flexibility may consider doing some domestic real estate shopping.

CHIPS AND SCIENCE ACT

The U.S. Department of Commerce will oversee $50 billion in investments to expand domestic manufacturing of mature and advanced semiconductors

$50 BILLION

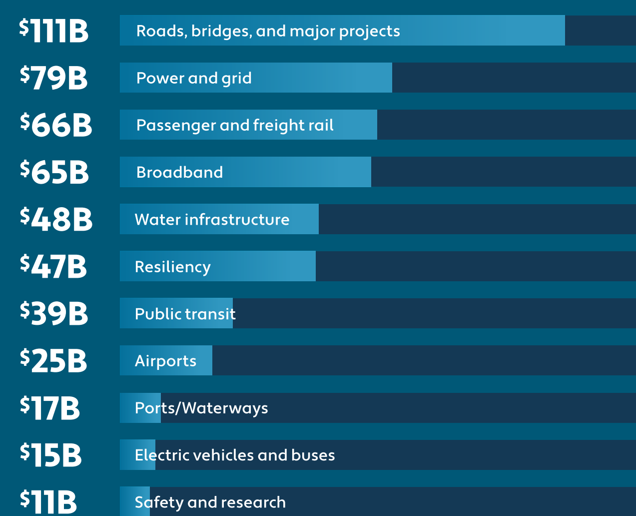
IN INVESTMENTS OVER 5 YEARS



SOURCE: *McKinsey & Company*

INFRASTRUCTURE INVESTMENT AND JOBS ACT

The act provides for $1.2 trillion in spending, roughly $550 billion of which would be new federal spending to be allocated over the next five years



SOURCE: *EY*

MANUFACTURING

Supply chain issues continue amid geopolitical challenges

It's hard to remember a world before constant supply chain issues, and it doesn't look like they'll be in the rear view any time soon. While it seems like the supply chain is stabilizing after a tumultuous few years (there's only been a **3% increase** in disruptions over 2022), disruptions are still happening. Between January and June 2023, supply chain risk management platform Resilinc recorded 8,197 supply chain disruptions, such as shutdowns, production halts, warnings/citations, and labor accidents. According to a **study from McKinsey**, companies across industries can expect a supply chain disruption that lasts a month or longer to occur about every four years.

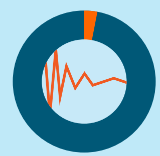
One of the biggest factors behind supply chain delays and issues is labor disruptions like strikes and layoffs. In the first two weeks of the six-week-long United Auto Workers strike across Ford, General Motors, and Stellantis plants, the auto industry lost over $3.9 billion, according to **Michigan-based consulting firm Anderson Economic Group**.

SUPPLY CHAIN ISSUES PERSIST BUT MAY STABILIZE

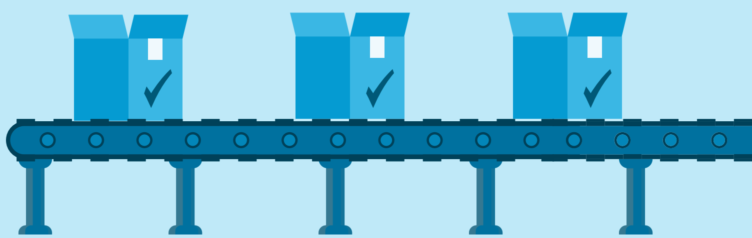
8,197

supply chain disruptions were documented across diverse industries throughout the first half of 2023

3%



This represents a marginal year-over-year increase of only 3%, suggesting a trend of stabilization in the supply chain compared to previous years



TOP 10 REPORTED DISRUPTIONS FROM JANUARY TO JUNE 2023

- Factory fires
- Mergers and acquisitions
- Business sale
- Leadership transition
- Factory disruption
- Legal action
- Labor disruption
- Cyberattack
- Port disruption
- Recall

SOURCE: *GlobeNewswire*

The effects of geopolitical unrest continue to ripple and disrupt supply chains. Fuel prices soared in 2022 after Russia's invasion of Ukraine, for example. And while prices have leveled out in the year or so since, crude oil prices are **predicted to rise in 2024**. More frequent and **severe weather events** are also disrupting supply chains. Wildfires, hurricanes, and even higher- or lower-than-usual temperatures impact ports, highways, and factories worldwide.

THE SUPPLY CHAIN GOES DIGITAL

If the rest of the factory is going high tech, shouldn't the supply chain too? A digital supply chain uses integrated technology to give stakeholders and participants near-real-time insights about what's happening at every step of the chain. Stakeholders have more visibility into supplier performance and customer needs, which allows them to spot potential problems earlier in the process. Oracle NetSuite suggests a digital supply chain can **increase on-time delivery to customers by 8% and reduce costs by up to 50%**.

It also might be able to better predict customer demand. As companies and consumers adjust to life after the pandemic, we're finding out which trends are here to stay (remote work, our love for sourdough bread) and which are falling by the wayside (remember "Tiger King"?). Estimating wrong can be costly; Peloton built a factory to produce more bikes after demand exploded during 2020 and 2021. **It completely misjudged what its market would be** when gyms and fitness centers reopened.

DROP SHIPPING TRENDS

Some companies are opting to save costs on warehouses and taking a new approach to customer order fulfillment: **drop shipping**. When a seller takes an order from a buyer, the seller orders that item from a supplier, who ships it directly to the customer on behalf of the seller. But because the transaction involves multiple companies, multiple transactions, and often a few states, it can complicate sales tax.

INTRODUCING PRODUCT AS A SERVICE

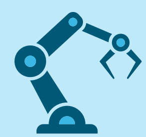
Some car manufacturers are finding opportunity in offering their **product as a service**. **Volvo and Porsche**, for instance, are giving customers usage of cars for an enrollment fee and monthly subscription. This gives drivers access to a car without the commitment of a lease or the costs and responsibility of registration and maintenance, and it gives manufacturers consistent revenue streams and offers more predictable demand. Plus, manufacturers can get insight into how customers are using their products.

Manufacturers can also get in on the XaaS (anything as a service) model with *servitization*, or providing services like maintenance, repair, and upgrades after the original sale is made. Offering services in lieu of or in addition to selling products can complicate taxability for a business. Each state has different rules and regulations for how services are taxed, and businesses might find themselves subject to use taxes where they only had to worry about sales tax previously. And if you're adding a recurring billing or subscription sales model, your business has that many more chances in a year to get sales tax right.

EXAMPLES OF PRODUCT AS A SERVICE

SOURCE: Oracle (1), Oracle(2)

Car manufacturers offering customers usage of recent models for an up-front enrollment fee and a monthly subscription fee



Welding robot manufacturers offering customers a certain number of welds for a set price rather than selling the robot itself

Engine manufacturers maintaining engine accessories for a fixed rate per hour (thrust as a service)

Lighting manufacturers offering installation, maintenance, and end-of-life disposal of new lighting in buildings, charging the customers only for the light they use

MANUFACTURING

How manufacturing trends affect sales tax nexus

While businesses in every industry deal with expanding tax obligations based on nexus, those in the manufacturing sector face unique challenges.

In order to stay agile and mitigate the effects of supply chain disruptions, manufacturers have been reshoring their operations and broadening their vendor lists. But having inventory or operations in more places subjects them to physical nexus. And while a remote workforce may enable businesses to attract much-needed talent, having employees across a number of states can trigger tax obligations.

Even adding services to your list of offerings for your customers could change the way your business is taxed. When you add in that each state has different, ever-changing rules and regulations for how products and services are taxed, tax compliance can get complicated quickly. Indeed, keeping up with changing tax laws and guidelines is the **number one tax compliance headache** for 54% of manufacturers that responded to a 2022 survey.

Economic nexus, the triggering of a sales tax obligation based on business activity in a state, also continues to be a challenge for manufacturers. This is especially true when manufacturers can and do sell directly to vendors. If you have nexus with the state where your vendor is located, you'll need to collect and remit the applicable sales tax or a valid exemption certificate at the point of sale.

Economic nexus can also impact a manufacturer's purchases. If you buy supplies from a vendor with nexus, you'll need to pay sales tax or provide the vendor with a valid exemption certificate. If the vendor doesn't have nexus, you may be responsible for remitting use tax directly to your state tax authority.

MANUFACTURING

Exemption certificate challenges

Even tax-exempt businesses aren't excluded from the complexity of compliance. Many states include exempt sales of products or services in their **economic nexus thresholds**, so it's imperative to monitor sales into each state and register to collect and remit tax when sales reach the nexus threshold.

Not having the right paperwork on file at the time of sale can be costly. In March 2023, the District of Columbia Court of Appeals held that **exemption certificate data provided after the time of sale is invalid** when a D.C.-area hospital sought a sales tax refund of approximately $1 million on taxes paid on prepared meals for resale. But since the hospital failed to provide the required resale certificate at the time of purchase, it was ruled that they were not eligible for a refund.

Whether your business is an exempt buyer or seller of exempt products, you're going to need the documentation to back it up. Manufacturers often have to deal with hundreds or even thousands of exemption certificates, and there's a lot of room for error if your team is manually collecting, verifying, and storing them. Missing exemption certificates can be an issue during state audits, and can result in significant penalties, like what happened with **JL Marine Systems**.

Some companies are turning to **artificial intelligence to manage sales tax and exemption certificates**. Not only does automation software take the burden of compliance off businesses, but those software providers are using AI to power their own solutions. Avalara, for example, uses built-in machine learning to validate exemption certificates stored for customers.

"Artificial intelligence holds great promise when it comes to dramatically reducing the time it takes to do routine tax compliance tasks," says Kael Kelly, Avalara General Manager of Certificates and Tax Research. "For instance, Avalara uses machine learning in our software to assist in validating exemption certificates. We also believe customers will soon be able to use generative chat to help research tax rates and laws."

Kelly is optimistic about the future of AI in compliance: "In the future, AI could not only automate high-volume tasks, it could potentially recommend ways to improve workflows, prioritize work, and increase compliance at a lower cost."

MANUFACTURING

New sales channels, new problems

Many manufacturing companies are making changes to the way they sell by adopting new sales channels. There are advantages to selling directly to customers and through marketplaces – it allows you to reach more customers and accelerate growth. But as your customer base grows, so can your tax obligations. You need a system in place to track nexus thresholds and easily register to collect and remit tax in new jurisdictions.

B2B MARKETPLACES HAVE UNIQUE COMPLIANCE LAWS

Businesses selling through an online marketplace should be aware of the laws and regulations for marketplace facilitators and sellers. Some marketplaces are required to collect sales tax on behalf of sellers, and some aren't. Brush up on your **marketplace facilitator knowledge** before you make a costly mistake.

In addition to dealing with economic nexus and marketplace facilitator laws like their business-to-consumer (B2C) counterparts, B2B marketplaces must validate exempt sales by collecting and maintaining exemption certificates for each and every third-party seller. They must also properly validate, document, and report both taxable and exempt sales. It's an enormously burdensome task.

CROSS-BORDER GROWTH

Cross-border ecommerce is growing. In fact **64% of manufacturers**, retailers, and logistics service providers surveyed either conduct cross-border ecommerce or plan to within the next year. But new frontiers often mean new challenges, like delayed shipments, customs compliance, supply chain costs, as well as tariffs and duties.

E-invoicing mandates are becoming popular globally, and while they're not yet required in the U.S., manufacturers buying or selling internationally will want to become familiar with **electronic invoicing processes**.

MANUFACTURING

This time, it's personal: Property tax issues

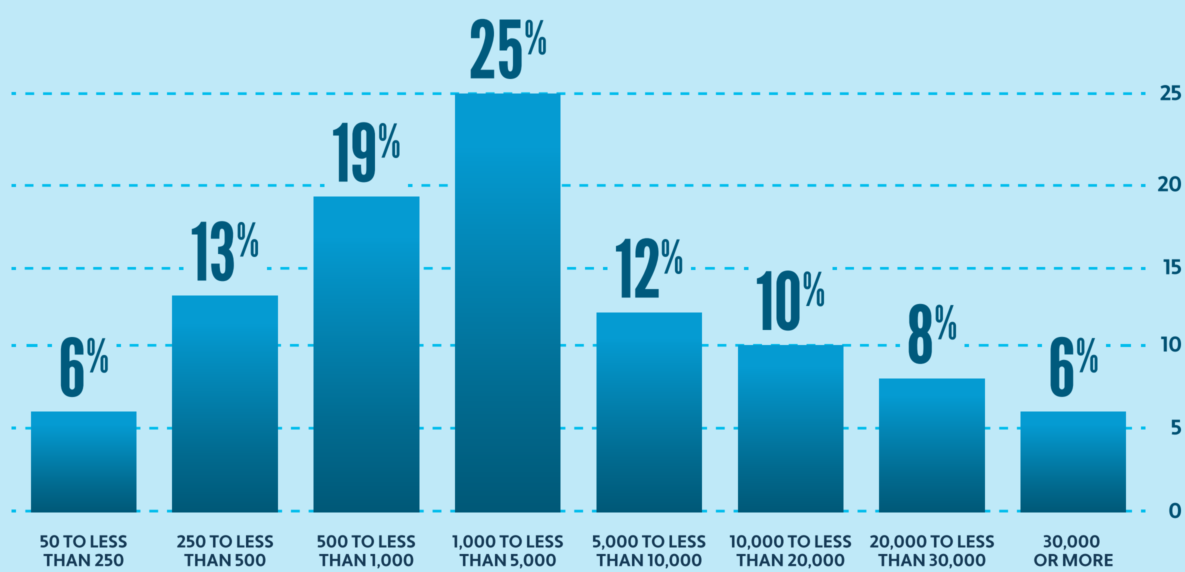
According to a **recent market research study**, 56% of enterprise companies surveyed receive between 500 to 10,000 property tax bills each year. Each of these bills must be received, tracked, responded to, and paid. And for small businesses without a dedicated tax team, that can mean a lot of time spent on non-revenue-generating business. Every state has its own rules and regulations when it comes to property tax, and those rules are continually evolving.

Property tax isn't just real estate. Personal property tax includes things like office supplies, machinery and equipment, and even vehicles. Not every state taxes business personal property, however. So if you're planning on building a new warehouse or factory, the location can make a big impact on what your tax bill looks like.

Tax compliance for both **real and personal property** can get complicated quickly. If your team is managing it manually, you could be losing valuable time and money, and opening yourself up to costly mistakes.

ANNUAL PROPERTY TAX BILL VOLUME

Property tax bills received, tracked, paid per year. Responses from 150 U.S.-based enterprise businesses.



SOURCE: *Avalara/Potentiate survey*

MANUFACTURING

Environmental fees

According to the **U.S. Environmental Protection Agency**, the manufacturing and raw materials industries were responsible for 23% of greenhouse gas emissions in the U.S. in 2021. To combat the environmental effects of eco-unfriendly activities, a number of states have started imposing environmental fees on companies that use or create materials like hazardous waste or lead-acid batteries.

Since these types of fees don't typically fall inside a tax department's normal purview, it can be challenging to stay on top of them. Tax or finance departments may not know about the applicable fees until well after they take effect, or if they do know about them, they may not have the information needed to comply with the fees.

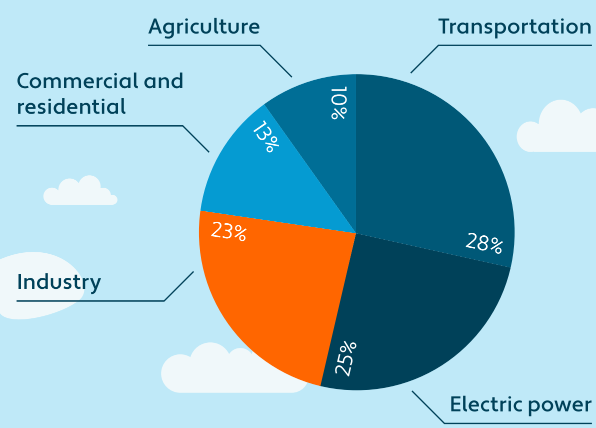
If your company, like many, tends to operate in silos, it might be time for some cross-departmental collaboration.

ENVIRONMENTAL FEES

According to a 2023 U.S. Environmental Protection Agency report, the manufacturing and raw materials industries were responsible for 23% of greenhouse gas emissions

SOURCE: *EPA*

U.S. GREENHOUSE GAS EMISSIONS BY ECONOMIC SECTOR IN 2021



SUSTAINABILITY

It's not just fees that are driving companies to be more environmentally conscious – consumers and corporate purchasers are **increasingly considering carbon footprint** when they make buying or investment decisions. Thus, manufacturers are incentivized to use less water, reduce waste, and commit to other sustainable practices.

With all these changes and trends, it sure looks like businesses in the manufacturing industry are in for an interesting year. But not to worry – Avalara will be right there with you, keeping track of tax changes and helping you understand how they might affect your business.

How Avalara can help

Avalara Exemption Certificate Management allows manufacturers to collect, store, and manage their exemption certificates, making it easier to stay tax-compliant and audit-ready. Coupled with Avalara AvaTax, it can also monitor for potential sales tax obligations and collect the certificates you need from customers in new states.

EXPLORE SOLUTIONS

UP NEXT: LODGING

Lodging

People want to travel. Where they stay – traditional hotel, extended-stay hotel, or short-term rental (STR) – depends on which accommodations best meet their needs. Changing consumer preferences are impacting the lodging industry, as are STR restrictions, and crackdowns on STR hosts who aren't registered or collecting taxes as required by law.

LODGING

Lodging providers respond to seesawing consumer demand

Situations change. Consumer preferences change. Through it all, people travel if they can, how they can, where they can.

During the height of the pandemic, once travel was permitted, many shirked hotels and flocked to short-term rentals. Travelers **shunned cities** and visited beaches, islands, mountains – anywhere with elbow room that allowed for escape from the homes where we lived/worked/schooled/recreated. Over 75% of hotel rooms in the U.S. were **unoccupied** in April 2020, and in August 2020, occupancy rates in urban hotels were down more than half nationally compared to August 2019.

Now the pendulum has swung the other direction. Hotels are filling, especially in cities. Average U.S. hotel occupancy in 2023 is on track to reach **63.8%**, close to the pre-pandemic level of 65.9%; and from the beginning of the year through September 5, 2023, hotel occupancy in New York City averaged **87.5%** of capacity. On the other hand, strong supply growth could very well **depress occupancy rates** for short-term rentals in 2023 and 2024.

Business travel is contributing to the rise in hotel occupancy rates. According to the **State of Travel 2023 report** by Skift Research, 56% of business travelers surveyed in March 2023 had traveled more in the past six months than before the start of the COVID-19 pandemic, while only 21% had traveled less. Yet business travel isn't likely to return to 2019 levels until **late 2024** or early 2025.

Flexible/hybrid working situations are allowing people to travel more and stay longer, leading to an increase in *bleisure* (a blend of business and travel): Global spending by bleisure travelers is expected to more than double by 2027 ($360 billion) as compared to 2021 ($150 billion). Skift reports that some companies are even changing policies to meet their employees' bleisure expectations.

Per their research:

- 46% offer flexible work hours
- 54% encourage employees to take personal time before or after a business trip
- 34% reimburse some personal vacation expenses (up from 26% in 2021)

Recognizing this, a growing number of hotels cater to guests' business needs, offering co-working and meeting spaces, lobby parties, and private dining events. Perhaps as a result of these policies, 30% of the U.S. business travelers surveyed by Skift traveled for an extended time (more than 10 days) away from home.

Yet there's conflicting data on business travel recovery. Rising inflation is putting a damper on travel spending, according to Skift. Meetings that once (i.e., before the pandemic) seemed like they had to be held in person now seem just fine over Microsoft Teams or Zoom. Given these and other considerations, it may be a while before business travel spending fully rebounds.

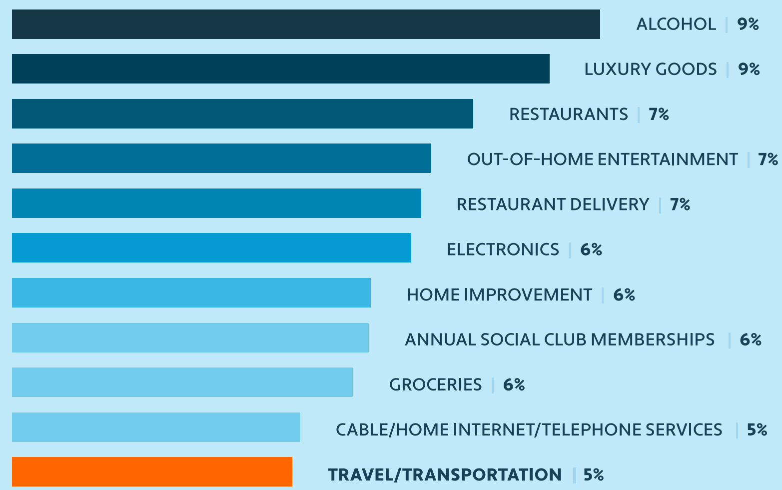
And indeed, business travel outlooks are somewhat pessimistic: About 25% of U.S. business travelers surveyed and more than 50% of U.K. business travelers surveyed believe "it is highly unlikely that [business travel] will reach 2019 levels ever again."

Still, as we noted at the start, the desire to travel runs strong right now.

Though 60% of U.S. consumers surveyed by Skift said inflation would impact the way they intended to travel, they're still prioritizing travel spending over other discretionary items like alcohol, eating out, and luxury goods. In fact, only 5% of the survey respondents planned to cut travel/ transportation expenses in Q1 2023. Moreover, lodging spending increased 43% year over year from February 2022 to February 2023.

CATEGORIES FOR WHICH SPENDING HAS OR WILL BE CUT DUE TO INFLATION

SOURCE: *Skift*



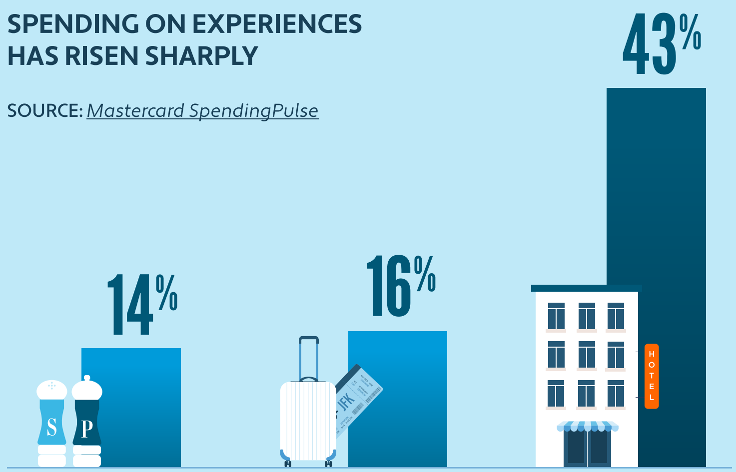
ONLY

5%

of survey respondents planned to cut travel expenses

SPENDING ON EXPERIENCES HAS RISEN SHARPLY

SOURCE: *Mastercard SpendingPulse*



LODGING SPEND INCREASED

43%

YoY from February 2022 to February 2023

Lodging

LOCAL ACCOMMODATIONS TAXES

There are roughly

4,000

locally administered accommodations taxes

SOURCE: *STRI*

TAX REMITTANCE REGULATIONS

According to a 2022 study by the National League of Cities,

82%

of surveyed cities require short-term rental hosts to remit taxes directly to the city

5%

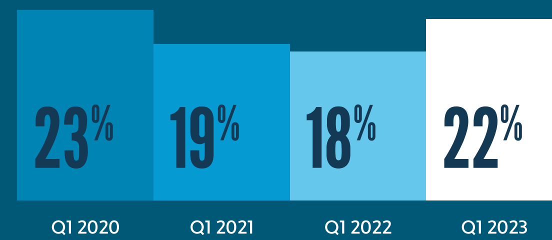
require the platform to collect and remit local taxes on the hosts' behalf

SOURCE: *NLC*

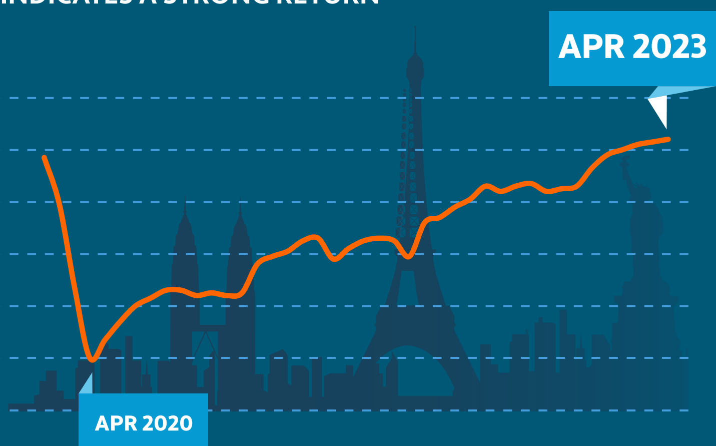
URBAN CENTERS MAKING A COMEBACK

22% of travelers surveyed visited urban centers in Q1 2023; down from Q1 2020 but up from Q1 2021 and Q2 2022

SOURCE: *Skift*



GLOBAL TRAVEL HEALTH INDEX SCORE INDICATES A STRONG RETURN



Global travel surpassed 2019 (pre-pandemic) levels for the first time in April 2023, exactly three years after its lowest point

SOURCE: *Skift*

68%

of survey respondents experienced higher travel prices while booking personal trips in Q2 2023 over Q2 2022

SOURCE: *Skift*

12%

fewer staff was employed by the U.S. accommodations industry in May 2023 than pre-pandemic

SOURCE: *Skift*

The global **short-term vacation rental market size** was estimated at

$109.76B

IN 2022

and is expected to grow at a compound annual growth rate (CAGR) of

11.2%

FROM 2023 TO 2030

SOURCE: *Grand View Research*

LODGING

Hotels are back (oh, yeah)

Skift predicts hotel revenues to be extremely close to pre-pandemic levels in 2023, just 1% below 2019 levels. This is a marked improvement over hotel revenues in 2022, which were 8% lower than in 2019.

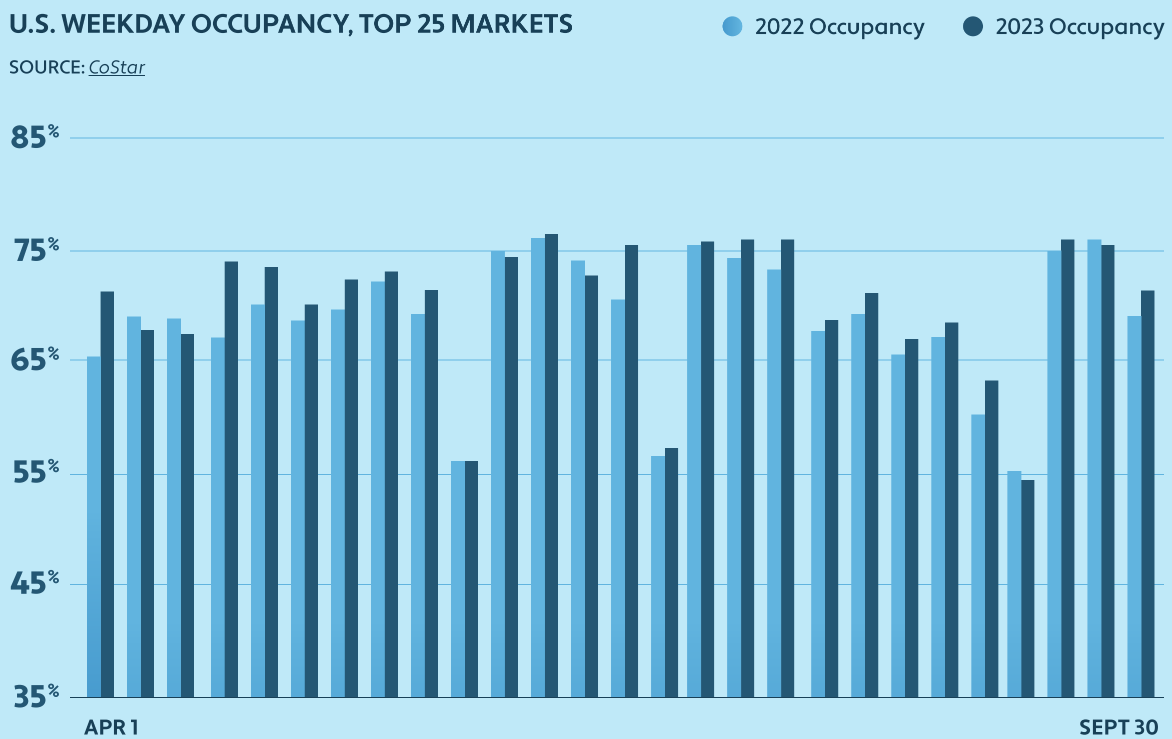
But revenues don't tell the whole story.

Though average daily rates (ADR) and occupancy rates usually recover in pace with each other, their paths are diverging. Revenue per available room (RevPAR) was up 8% from 2019 to 2022 in North America, and ADR was up 14%, yet occupancy was down 5%. The higher daily rates are helping bring hotel revenue nearly back to 2019 levels despite still-depressed occupancy rates.

Fast-forward to September 2023, and U.S. occupancy is showing signs of significant growth. The U.S. hotel industry sold a **near-peak number of rooms** that month.

U.S. WEEKDAY OCCUPANCY, TOP 25 MARKETS

SOURCE: *CoStar*



LODGING

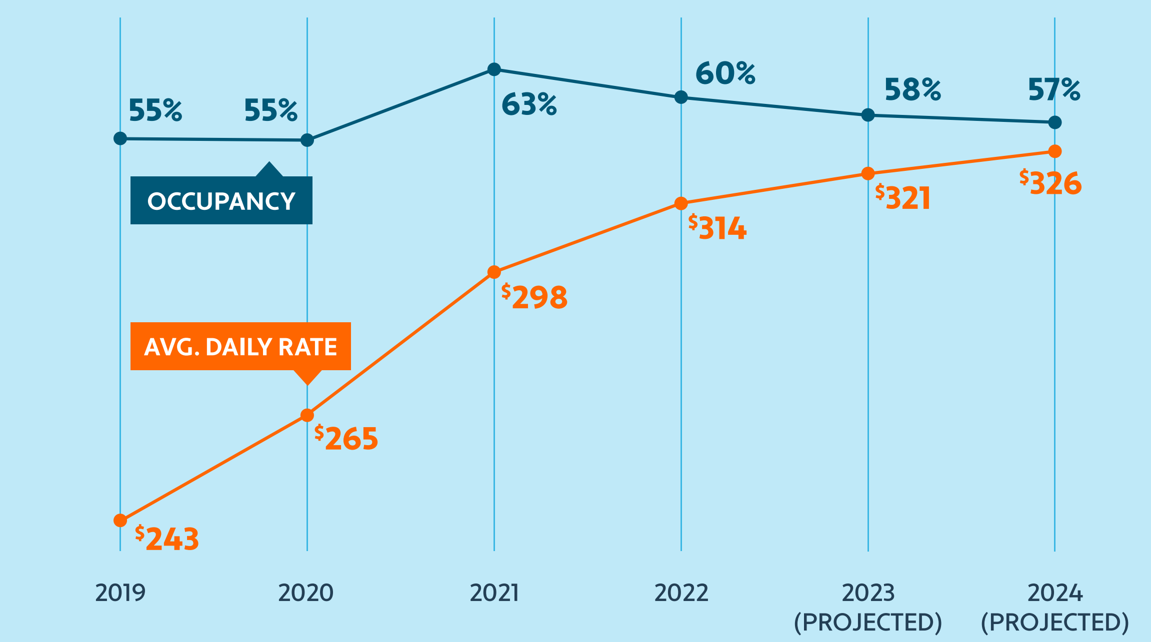
STRs are still going strong (mostly)

The hotel sector has historically outperformed short-term rentals (STRs) – pandemic aside – and it's on top again today with 85% market share. But "short-term rentals are **closing the gap** with hotels." STRs nearly doubled their share of the market in just six years, from 8% in 2018 to about 15% in 2023. According to Skift, short-term rentals are now a $67-billion market in the U.S., comprising 18.6% of the overall accommodation sector.

The STR industry actually **defied predictions** of an "Airbnbust" during the first half of 2023. If strong supply growth leads to a second year of declining occupancy in 2023, rates likely won't drop as much as once expected. Indeed, occupancy should remain higher than pre-pandemic standards for the foreseeable future. While supply has grown steadily since before the pandemic, AirDNA (via Skift) says talk of "oversupply" seems unwarranted.

U.S. SHORT-TERM RENTAL INDUSTRY OUTLOOK

SOURCE: *AirDNA*

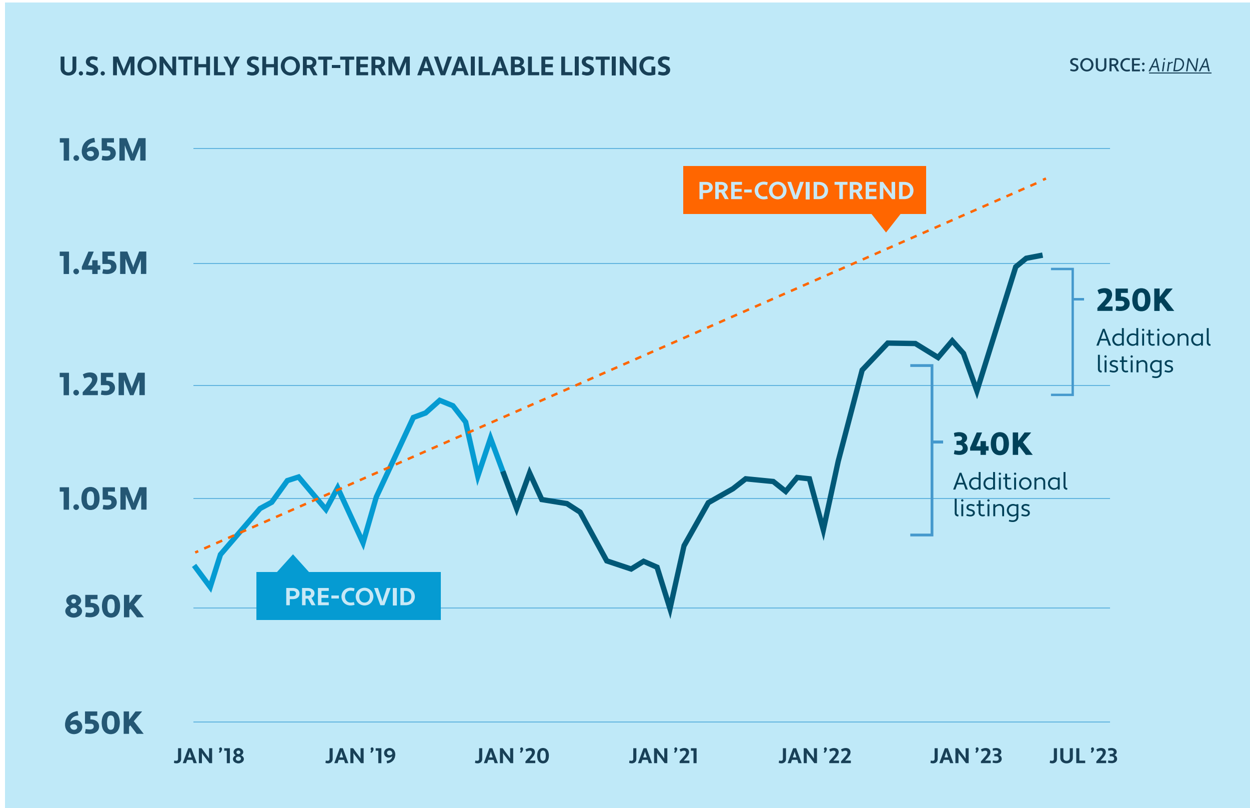


This isn't to say there haven't been bumps in the road. The excess of STR supply has driven down average nightly rates: Though nightly bookings nationwide increased **9% year over year** in July 2023, RevPAR dropped **2.3% year over year**, to $235.50.

Speaking at the Skift Global Forum in September 2023, Airbnb Co-Founder and CEO Brian Chesky admitted a lot of Airbnbs are "running at very low occupancy, maybe **20% or 30%**." He noted that charging a little less per night could help increase occupancy.

Fewer bookings at STRs doesn't necessarily translate to more bookings at hotels, or vice versa. The truth is, hotels and STRs both have a lot to offer. There's overlap between hotels and Airbnb, observed Chesky, but less than you might think.

That could be changing.



LODGING

Hotels and STRs are learning from each other

Hotels and STRs generally coexist peacefully and serve different needs, but **competition** for the same customers could be growing. As a result, hotels and STRs are taking lessons from one another. "Operators in both short-term rentals and hotels are thinking about how to serve the same consumer," observes **Skift**.

For instance, short-term rental hosts may stop requiring guests to do **chores** before they leave, especially if hosts charge a high cleaning fee. And professional property managers are providing round-the-clock services, much like a hotel concierge.

Meanwhile, more hotels are entering the extended stay space. According to Lodging Econometrics, roughly one-third of the construction pipeline for hotels in the U.S., or **30% of planned rooms**, are extended-stay projects.

And guess what? Hotels do short-term rentals well.

HOTELS ARE ENTERING THE SHORT-TERM RENTAL SPACE

Skift notes that hotels are increasingly pandering to the "**globe-trotting bleisure traveler**" and offering short-term rentals. Consumer preferences for STRs even for business trips is leading to "the blending and merging of different players in the accommodation industry" – a "muddled middle," as it were.

Overall, hotel-managed STRs tend to get higher scores for security, service, ease of resolving problems, and cleanliness than non-hotel-operated STRs. They have an upper hand in the three "C's" of hospitality: cleaning staff, commercial laundry, and a concierge service.

While some hotel-operated short-term rentals are located in or adjacent to the hotel that oversees them, hotels are increasingly moving into stand-alone residential properties.

HOTELS ARE GOING RESIDENTIAL

Some hotel companies are interested in developing more 100% branded residential properties, as they can be more profitable for them than traditional hotels.

"There's **big demand for Marriott stand-alone residences**," according to Dana Jacobsohn, Chief Development Officer of U.S. Luxury Brands and Global Mixed-Use at Marriott International. "They create more loyalty for our hotel brands and we're making a lot of money with them." Riyan Itani, Director and Founder of Global Branded Residences, agrees: "My prediction is we will have operators with more stand-alone branded residential than co-located [with a hotel], so they'll effectively become more residential managers than hotel managers."

This seems to be particularly true at the luxury level.

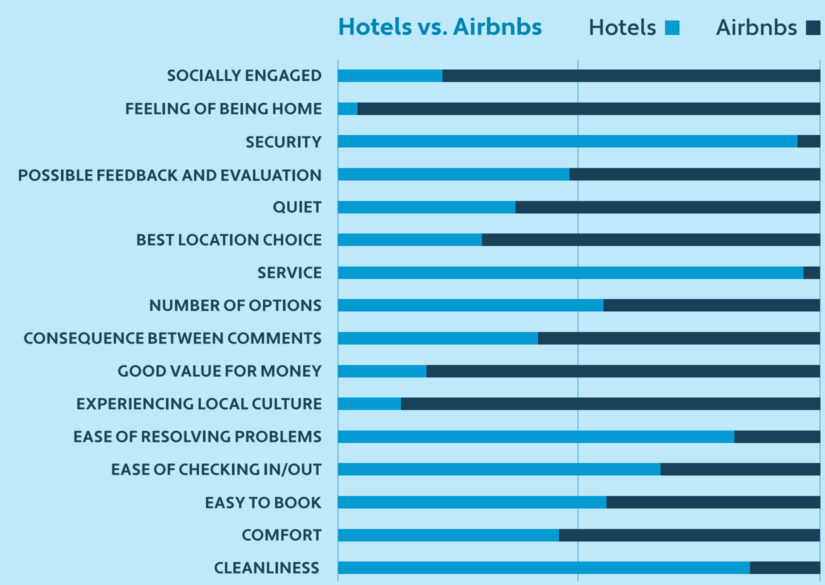
LUXURY IS WHERE IT'S AT

Hotels with ultra luxury offerings have seen gross operating profit margins more than double recently, from 15% in 2019 to 32% in 2022. No wonder luxury offerings are topping the future pipeline as a percentage of supply: 5.3% of future pipeline under construction in the U.S. is luxury, 4.6% is upscale, 3.7% is upper midscale, 3% is upper upscale, 2.5% is midscale, and only 0.9% is economy.

Stand-alone branded hotel residences – "Think **Ritz-Carlton Residences without the actual Ritz-Carlton hotel**" – are taking off, "particularly in the luxury space among wealthy international travelers." The first stand-alone Ritz-Carlton Residences opened in 2009, in response to customer demand. Today, 17% of Marriott's 128 global branded residential developments are stand-alone.

Marriott has 100 branded residential properties in the pipeline, and 27% are stand-alone. Other hotel brands, including Four Seasons and Hilton, are developing residential programs as well.

As hotels enter the STR space, short-term rental hosts are confronting some of the downsides of outsourcing to a professional property manager.



RANKINGS BY CONSUMERS FOR HOTELS AND RENTALS

Airbnb properties score well on value and social engagement, but hotels are considered more reliable for easing problems, security, and cleanliness; Airbnb is trying to rebalance this

SOURCE: *Skift*

LODGING

Unexpected downsides of professionalization

Professional managers seem to make hosts more money. According to Skift, they generated 27% more revenue per available night premium than mom-and-pop peers in 2019, and 34% as of April 2023. So, perhaps it stands to reason that hosts have turned to them in droves. That, and the fact that **being on call 24/7 can be a drag**.

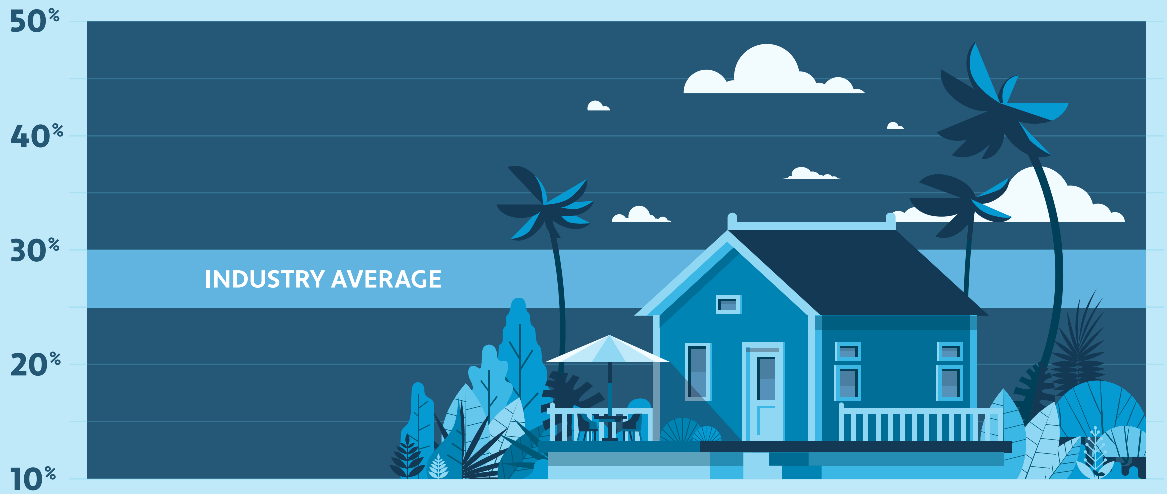
Large property operators (1,000+ units) grew 27% from April 2022 to April 2023, while their smaller counterparts (1–100 properties) grew only 7%. That may sound good, and maybe it is, but as just about any business that's grown rapidly can tell you, scaling is hard. Some large property managers now find themselves struggling with back-end operations.

As Skift observes, "property management is a game played on the ground, and scaling it efficiently and effectively remains hard." It's particularly hard to grow a property management company on a national level.

PROPERTY MANAGEMENT FEES CAN RANGE FROM FROM 10% TO 50%

% of the rental cost

Fees charged by vacation rental property management companies vary based on the company and the property location



SOURCE: *Lodgify*

Professional property managers that onboarded hundreds or thousands of properties had to hire a lot of people to take care of those properties. Some have had a hard time keeping up with all that needs to be done, and quality control has suffered. Unhappy STR owners are turning to smaller, local property managers or taking over management themselves.

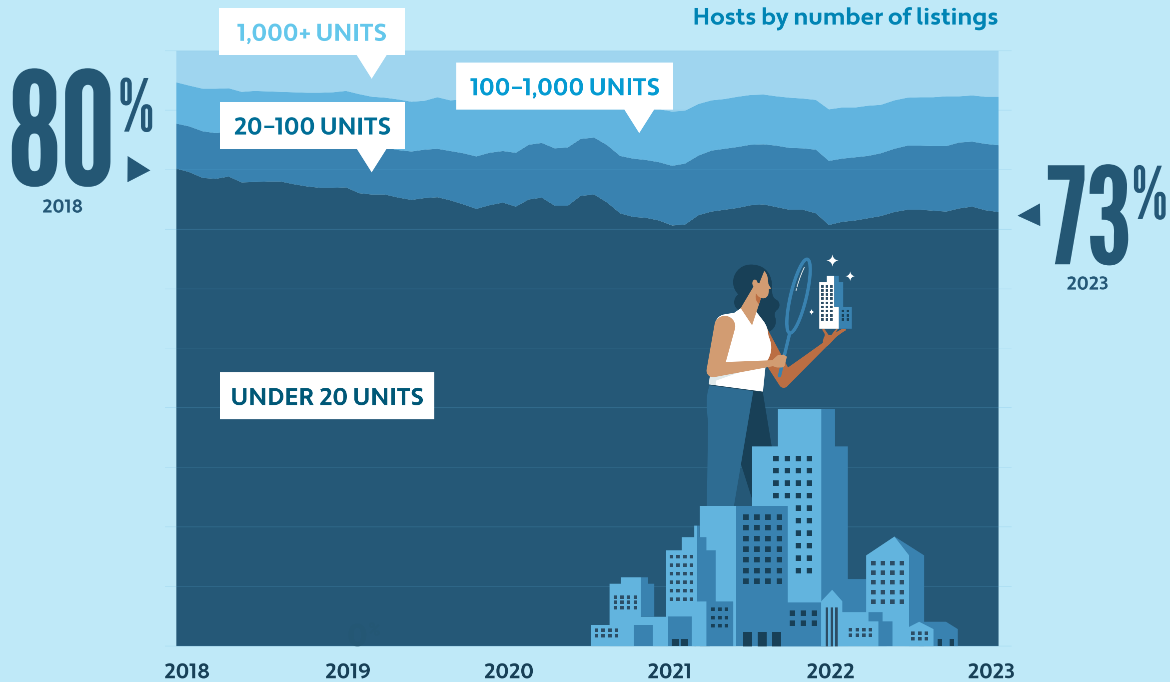
In an effort to rein in costs, Vacasa has laid off approximately 1,300 workers, or about 17% of its workforce. It plans to "maintain the strong service levels," but some investors are worried. In March 2023, **The Motley Fool** noted that "a lot goes into vacation rental management, and it will be challenging for the company to maintain its service standards with fewer people." In October 2023, share prices of Vacasa and Sonder (another company in the space) plummeted.

Despite the leap to professionalization that occurred during the pandemic, individual hosts remain by far the largest cohort of hosts. The numbers are down a bit, but just a bit: 80% of hosts were independent at the beginning of 2018; 73% of hosts had fewer than 20 units as of March 2023. Skift believes the vast majority of those hosts have only one or two rental properties.

No matter how they're managed, a growing number of short-term rentals are facing existential problems. Restrictions on STRs are getting harder to avoid.

MOST VACATION RENTALS ARE STILL RUN BY INDEPENDENT HOSTS

But the number is dwindling. In 2018, 80% of hosts had fewer than 20 units. In March 2023, 73% of hosts had fewer than 20 units.



SOURCE: *Skift*

LODGING

Cities get serious about restricting STRs

Local governments from Honolulu to New York City are setting limits on short-term rentals, and they're getting serious about enforcement.

Some communities, such as Dallas, Texas, are **banning STRs from neighborhoods** zoned for single-family homes. Such decisions aren't lightly made: Dallas debated the issue for four years, perhaps because the law stands to render up to 95% of registered STRs illegal. The ordinance went into effect in July 2023, but the city held off on enforcement until December 14, 2023, to give hosts more time to comply.

New Orleans passed an ordinance in March 2023 that **restricts STRs in residential zones**; it allows each operator only one STR permit as of July 1, 2023. The operator must be a natural person (i.e., not a corporate entity) and must live on the same lot as the STR unit. They also need to resolve complaints within one hour, have at least $1 million in commercial general liability insurance, and include the STR permit number in all advertisements.

After a group of short-term rental operators challenged the constitutionality of the ordinance, the city was **enjoined from enforcing** the STR regulations until further notice. New Orleans will not accept applications for any new short-term rental licenses or STR license renewals until the issue is resolved.

This is just a smattering of what transpired in 2023. New requirements or restrictions were also established in **Columbia**, South Carolina; **Kansas City**, Missouri; and **Sonoma County**, California. **Phoenix** is tightening restrictions as of January 15, 2024. **Louisville, Kentucky**, now requires hosts to live on a property for at least six months before applying for STR registration.

These new policies won't be the last.

Every community handles STR regulations differently, and some take a more holistic approach than others. Like Dallas and Kansas City, some are prohibiting new STR licenses in residential areas. Communities that believe they already have too many STRs are capping the number of licenses allowed and creating lottery systems for new or renewing permits.

That's the plan in San Diego, which has one of the biggest short-term rental markets in the country.

SAN DIEGO CAPS SHORT-TERM RENTALS

Once upon a time, San Diego placed no limits on short-term rentals. The number of STRs grew, and grew, and grew. And some people were happy. And some were not.

So in 2018, the San Diego City Council established **strict regulations for vacation rentals**. Among other requirements, STRs would only be allowed in a property owner's primary residence. However, after a referendum seeking to repeal the law received enough signatures to be put to a vote, the Council **repealed the short-term rental law** and went back to the drawing board.

Fast-forward to 2021: The City Council approved a **new STR ordinance** allowing one STR permit per individual and capping the total number of whole-home vacation rentals to 1% of the housing stock in most of the city. In the popular vacation destination of Mission Beach, the cap is a much higher 30%. The ordinance took effect **July 1, 2022**, but it didn't become unlawful to operate a short-term rental in San Diego without a license until May 1, 2023.

More than 12,000 STRs were estimated to be operating in the city when the ordinance went into effect in 2022. As of **January 2, 2024**, the city had issued 8,323 licenses as follows:

- 182 Tier 1 licenses (part time)
- 2,569 Tier 2 licenses (home sharing)
- 4,490 Tier 3 licenses (whole home, excluding Mission Beach)
- 1,082 Tier 4 licenses (whole home, Mission Beach)

San Diego was set to run a lottery for whole-home licenses but **canceled it** because the number of applicants didn't exceed the city's cap. There were no more Tier 4 licenses available as of January 2, 2024, and only 929 Tier 3 licenses remaining. (The City of San Diego updates the data regularly.)

Like San Diego, most jurisdictions aren't banning STRs outright. In some cases, however, the requirements are such that they may as well. New York City comes to mind.

NEW YORK: WELCOME TO MY HOME

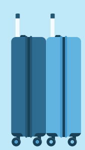
Life in New York City is *more* than in many other parts of the country. There are more people, more languages, and more **tourists** than in any other city in the United States. As of September 5, 2023, there are also more restrictions on short-term rentals than in any other jurisdiction, barring outright bans.

On January 9, 2022, New York City enacted its **Short-Term Rental Registration Law** (Local Law 18) requiring short-term rental hosts to register with the Mayor's Office of Special Enforcement (OSE) and include their short-term rental registration number on all advertisements for the property. Additionally, booking service platforms must verify that all STRs on their sites are valid and cannot process transactions for unregistered short-term rentals.

Few would argue that a registration requirement is unreasonable. These are businesses, after all. And given the trouble many jurisdictions have had with unregistered short-term rentals, prohibiting booking platforms from processing transactions by unregistered STRs seems a savvy move.

Where Local Law 18 goes too far, according to its critics, is that it requires STR hosts to live in the space they're renting out – and to be there while guests are staying there. It also caps the number of paying guests at two and prohibits hosts from applying for more than one short-term rental registration number.

AS OF SEPTEMBER 5, 2023, NEW YORK CITY'S SHORT-TERM RENTAL LAW:

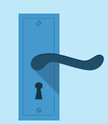


LIMITS GUESTS

No more than two paying guests can stay in a short-term rental. This eliminates the possibility of accommodating larger groups.

REQUIRES HOSTS TO BE PRESENT

This requirement transforms short-term rentals into a shared living experience.



PROHIBITS LOCKING INTERNAL DOORS

Guests cannot leave and lock their room behind them. All occupants need to maintain a common household.

SOURCE: *New York City Office of Special Enforcement*

Per the New York City Office of Special Enforcement:

> *"Short-term rental refers to renting out a home or apartment for any period shorter than 30 days. You cannot rent out an entire apartment or home to visitors for less than 30 days, **even if you own or live in the building**. This applies to all permanent residential buildings.*
>
> *Short-term rentals are only permitted if you are staying in the same unit or apartment as your guests, and you have no more than two paying guests at a time. The person renting out the home or apartment must 'maintain a common household' with the guests. Otherwise, the short-term rental is illegal. All other laws relating to the use of the space must also be followed (i.e., no sleeping in an area where it would be illegal to do so, such as an attic, cellar, or garage)."*

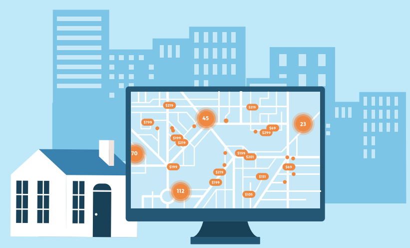
Inevitably, the law was challenged: Airbnb and three short-term rental hosts sued New York City (separately) in June 2023, calling the new rules "**a de facto ban against short-term rentals**." But the matter was quickly resolved. In August 2023, a New York Supreme Court judge **dismissed the lawsuit** filed by Airbnb and short-term rental hosts, freeing the ordinance to take effect September 5, 2023.

Pam Knudsen, Senior Director of Compliance Services at Avalara, wonders how these regulations will impact hosts who may have used short-term rental income to afford to live in New York City, as well as those small businesses once frequented by short-term rental guests.

> "Part of New York's appeal is its walkability. Local small businesses benefitted when visitors spent money within walking distance to where they were staying."

NEW YORK CITY SHORT-TERM RENTAL LISTINGS VANISHING

Between June to September 2023, short-term rental listings dropped from 22,500 to 4,600, likely due to Local Law 18 taking effect on September 5.



JUNE 4, 2023

22,500

LISTINGS

SEPTEMBER 5, 2023

Local Law 18 takes effect

SEPTEMBER 10, 2023

4,600

LISTINGS

SOURCE: *Skift*

LODGING

No more hiding from the taxman

The registrations now required by San Diego, New York, and a host of other jurisdictions are designed, in no small part, to ensure each and every **short-term rental complies with all regulations**. These include operational restrictions, safety mandates, and of course, tax obligations.

Short-term rentals are generally subject to state and/or local accommodations taxes, but noncompliance tends to be high: A 2022 study by **McGill University** determined that 45% of short-term rentals operating in Los Angeles were illegal. And as of July 12, 2023, between 1,500 and 1,700 of the STRs operating in Philadelphia, or nearly **85%** of the city's short-term rental properties, were unlicensed.

Enforcement has historically been difficult because unregistered STRs fly under the radar. But it's getting harder for short-term rentals to remain undetected; more and more jurisdictions are requiring STR hosts to post their license or permit numbers on all advertisements, including listings on booking agent platforms (e.g., Airbnb, Booking.com, and Vrbo). They're also holding the booking agents to account.

Philadelphia is cracking down on unlicensed STRs by requiring booking agents to remove unlicensed short-term rental listings from their websites. **New York City** will penalize the booking platforms as well as the hosts if such requirements aren't met. As these cities see results, other jurisdictions will undoubtedly follow their lead.

AI WILL FIND NONCOMPLIANT STRS

Requiring short-term rental platforms to delist nonregistered properties is one way to cut down the number of illegal STRs in operation, but it's not the only strategy being employed. A growing number of local governments, including Fort Worth and Galveston, Texas, rely on **data-mining solutions powered by artificial intelligence to identify noncompliant properties**.

Companies such as **Deckard Technologies** deploy data analytics and machine-learning to identify short-term rental ordinance violations. The tools scrape publicly available booking sites for short-term rentals then cross-reference the properties found with information held by tax authorities. Properties that seem to be lacking the proper permits and licenses are flagged for further investigation.

"Cities are also using this data-scraping technology to identify STRs that are registered with the state but not the city," says Knudsen. "Once they have that information, they're requiring the STRs to file local returns and remit payments for the missing periods." She says jurisdictions are also looking into newly registered properties, checking to see how long they've been listed on platforms like Airbnb and Vrbo. "Short-term rentals that were operating prior to registering with the city may be liable for back taxes."

AI and data-scraping technology beats city officials scouring Craigslist and other platforms for short-term rentals then cross-checking them with registered businesses – though that still occurs. In April 2023, after a deadly shooting took place at an illegal STR, a New Orleans city council member said the city was working to **hire more short-term rental inspectors**.

MORE REGISTERED BUSINESSES = MORE TAX REVENUE

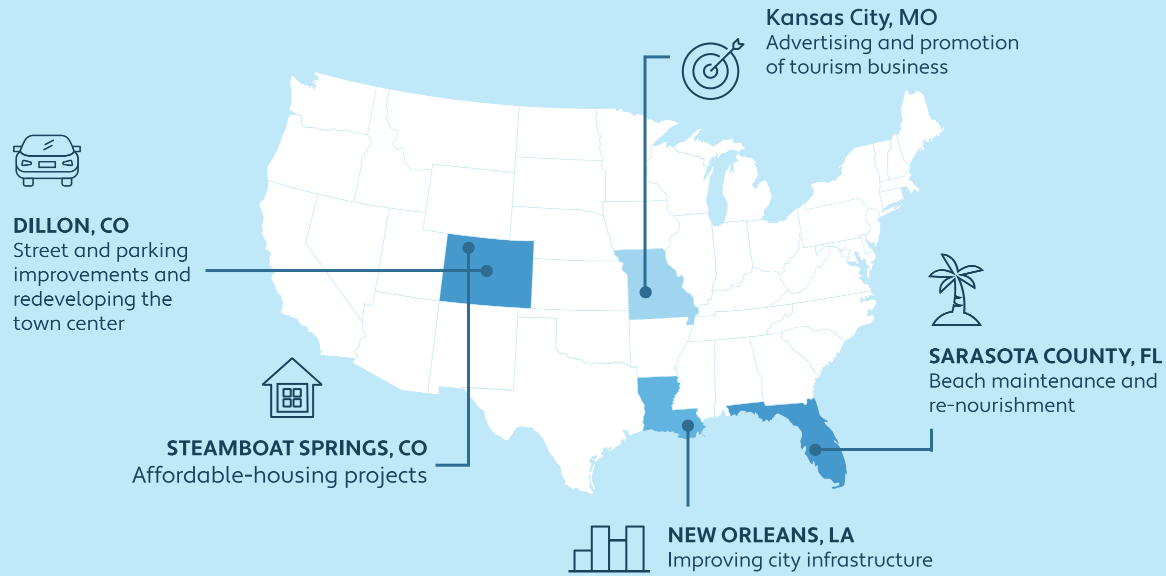
STRs that are registered and compliant generate more tax revenue for their communities than unregistered or noncompliant STRs. That, of course, is one of the main reasons local officials are turning to technology to improve compliance.

Real money is at stake. Martha's Vineyard generated about **$16.5 million** in STR tax revenue during the first three years Massachusetts taxed STRs. Long Beach, California, collected more than **$3.87 million** in tax revenue from its roughly 830 short-term rentals in the first half of 2023 alone.

Governments typically put STR lodging taxes to good use. Many communities use lodging tax revenue to promote local tourism in general and the hospitality industry in particular. Some use this revenue to improve infrastructure that benefits residents and tourists alike. And increasingly, communities are putting at least a portion of lodging tax collections toward affordable housing initiatives.

But collecting and remitting lodging taxes can be a real burden for businesses.

EXAMPLES OF HOW GOVERNMENTS USE STR LODGING TAXES



SOURCE: *Avalara*

HOW DO THEY TAX THEE? LET ME COUNT THE WAYS.

There are likely over 4,000 local accommodations taxes in the U.S., though the **State Tax Research Institute** says an exact count is impossible to ascertain. Since lodging taxes vary by location, determining local rates and exemptions is extremely burdensome.

For one thing, tax rates can change with the number of rooms in a property, observes Oliver Hoare, General Manager of Lodging at Avalara. Some jurisdictions in Washington state impose a **special hotel/motel tax** that applies only if there are 40 or more lodging units. Businesses with 60 or more units were once subject to a King County, Washington, **convention and trade center tax** on transient lodging charges, though as of January 1, 2019, the tax applies to all lodging businesses, no matter the number of units.

The number of rooms rented, or the number of adults in the room, can also affect tax rates: The **Rhode Island hotel tax rate** is 6% for room rentals but only 1% for whole-house rentals. And that's not all. A "resort" can be taxed differently than a hotel. Rooms located in a historic building can be taxed differently than those in contemporary lodging facilities.

The taxes themselves are certainly problematic, but there are other issues as well.

WHO PICKS UP THE TAX BILL?

One of the most troublesome aspects of lodging tax compliance is determining the answer to the most basic of questions: Who is responsible for collecting and remitting the applicable taxes?

If the host were the only party involved, taxes would clearly fall to them. Yet short-term rentals and other lodging providers often book through online travel agencies (OTA) and booking agent platforms – and **understanding the lodging tax obligations of marketplace platforms is hard**.

The relationship between an online travel agency and a merchant can work in a couple of different ways: The online travel agency can be the merchant, or the hotel or short-term rental host can be the merchant. If the OTA is the merchant, consumers pay a prepay rate when they book. If the hotel is the merchant, consumers pay a post-pay rate when they check in. Identifying the merchant of record is a key factor because it determines who's liable for what taxes.

It's also critical to determine whether an OTA or booking agent is considered a "marketplace" for tax purposes. Platforms classified as a marketplace facilitator may be subject to marketplace facilitator laws and therefore may need to pay tax on the net rate as well as on the markup (or margin). Platforms not classified as a marketplace, for tax purposes, may only need to pay taxes on their markup.

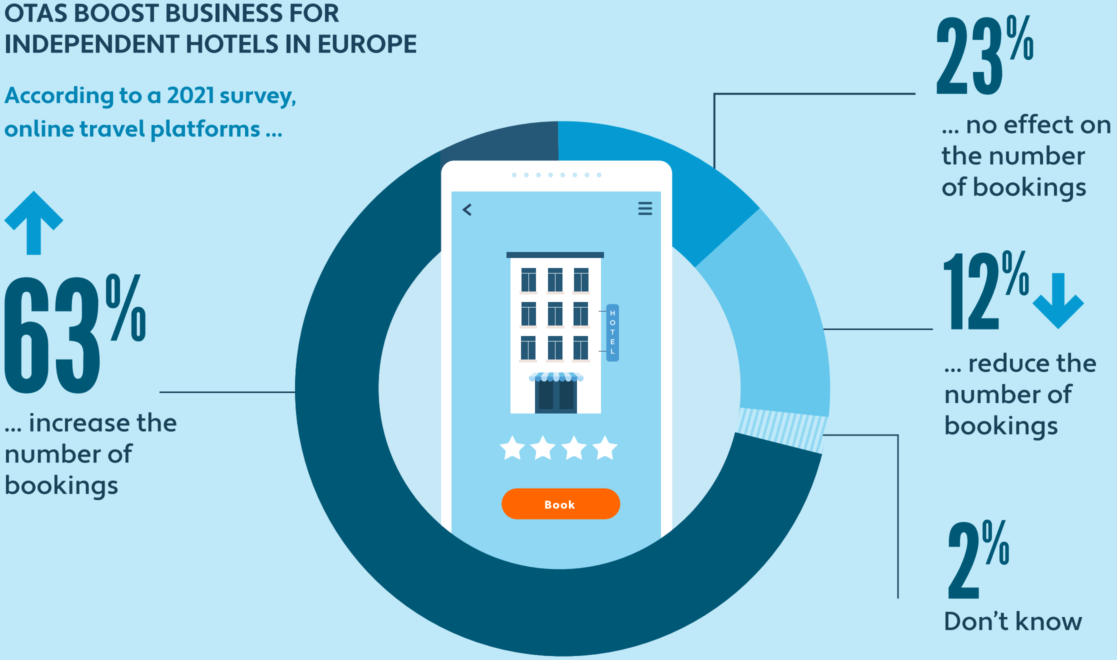
It's complicated – and complications are compounded by the fact that marketplace facilitator laws in many states hold marketplace platforms responsible for some occupancy taxes but not *all* occupancy taxes.

Furthermore, some state marketplace facilitator laws specifically *do not* apply to occupancy taxes. That's how it is in Washington state, where a business providing online travel agency services for short-term lodging isn't considered a **marketplace facilitator**. Yet even Washington generally holds OTAs liable for applicable taxes on their markup.

And sadly, when it comes to lodging tax, some states simply don't provide clear guidelines for marketplace facilitators or the businesses that rely on those platforms.

OTAS BOOST BUSINESS FOR INDEPENDENT HOTELS IN EUROPE

According to a 2021 survey, online travel platforms ...



SOURCE: *Hospitality Net*

WHAT ABOUT THE FEES?

Determining who's liable for applicable fees, as well as any taxes due on those fees, can be another quagmire. And there tend to be a lot of fees: online booking fees, cleaning fees, pet fees, resort fees ...

Which of these fees are subject to sales and/or lodging tax? Who's responsible for collecting and remitting them? Is it the booking agent, the OTA, or the lodging provider themselves?

It may not be the same entity. Also, the answer varies by location.

To address a gap in the city's hotel tax, **Anaheim, California,** broadened the city's definition of a lodging operator to include online and other travel companies, along with hotels, motels, and short-term rentals. The city further required online and other travel companies to collect taxes based on the full lodging charge, including but not limited to internet fees, overnight guest parking fees, and resort fees.

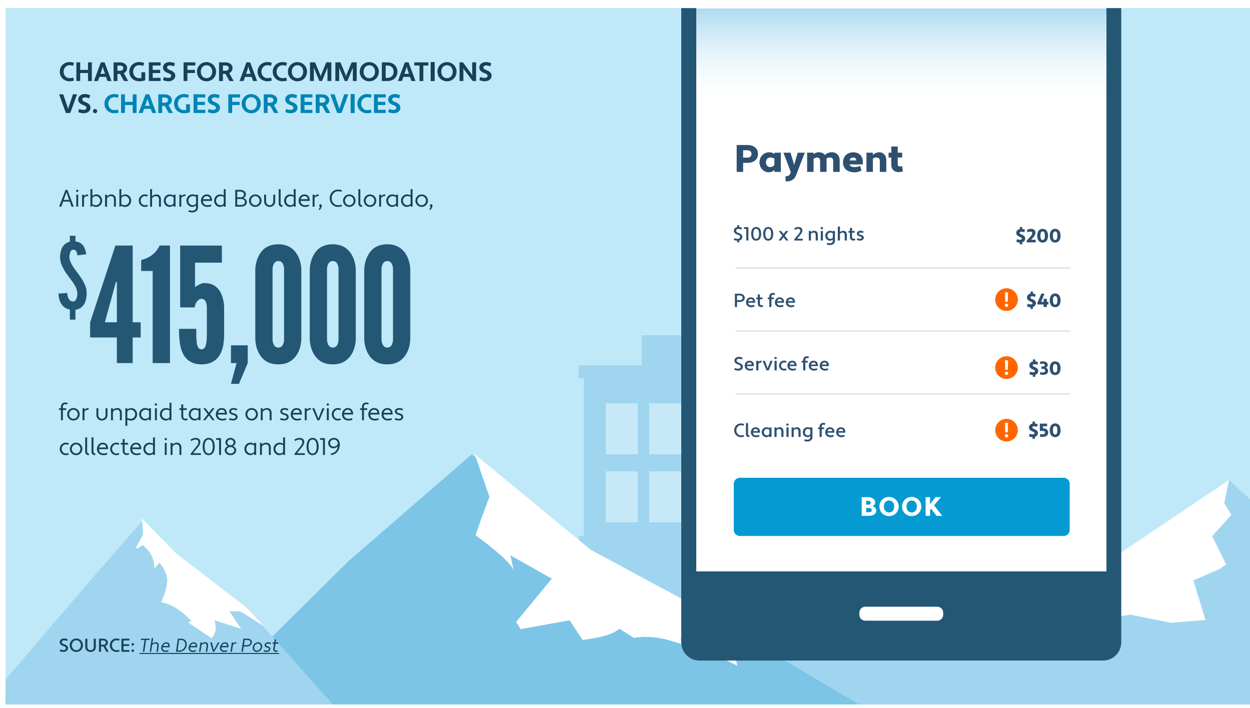
Depending on who collects the tax, or the type of room charge, the tax is remitted either to the tax authorities or to the lodging provider. So, that's fun.

The city breaks it down like so:

- An OTA must forward tax collected on a flat rate – known as a discount room charge – to the hotel or motel, which remits the tax to the city. If the guest pays more for the room than the travel company paid the hotel or motel (defined in Anaheim's code as a facilitation fee), the OTA must remit the balance of tax due to the city.
- An OTA collecting rent for an Anaheim short-term rental must pay the city's full tax on the amount of the stay.
- A hotel, motel, or short-term rental that collects the full amount of a stay from a guest and pays a flat commission rate to an OTA (for booking) must submit the full tax due to the city.
- Hotels, motels, and short-term rentals are responsible for applying and collecting tax on overnight guest parking, resort fees, and other charges.

This is complicated, and it's just one city. Platforms that facilitate bookings for hotels and short-term rentals nationwide have to deal with thousands of Anaheims.

No wonder the question of who's responsible for taxing applicable fees can become contentious. Airbnb is fighting a **$415K rental tax assessment** the city of Boulder, Colorado, says it owes on guest fees. For its part, Airbnb maintains that Boulder County wrongly taxed guest fees.



LODGING

What else could affect the lodging industry in 2024?

TECHNOLOGY WILL CONTINUE TO SHAPE THE LODGING INDUSTRY

We talked previously about how AI is already helping local tax authorities find noncompliant short-term rentals. On the other side of the transaction, short-term rental hosts and property managers are using technology to streamline communications with guests and keep tabs on properties.

Skift Research believes generative AI will have an increasingly significant impact on various aspects of the travel industry, such as:

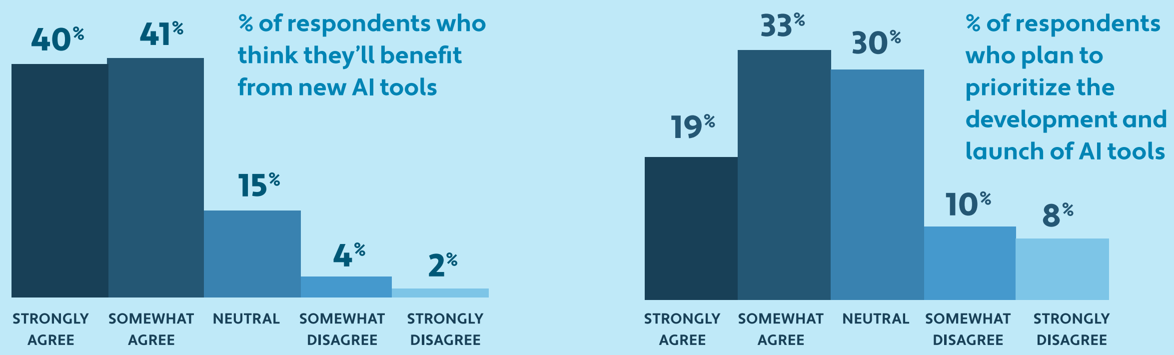
- **Customer support.** LLMs (large language models, a type of AI that works with language) can improve chatbot experiences and provide more relevant customer support.
- **Reputation management.** AI can help businesses respond to online reviews more effectively.
- **Performance advertising.** Gen AI can streamline the travel planning process by improving the way information is summarized and presented.

According to a survey, 81% of Skift readers that work in or with the travel industry believe new tools based on generative AI will benefit their travel organizations. That said, most don't see their organization prioritizing AI tools. A separate **Accenture study** on AI maturity bears that out: The travel industry was found to be among the least advanced industries for AI.

Focusing on technology can pay off: The travel booking app and online travel marketplace Hopper has grown more than any OTA other than Vrbo since 2019, due in part to its focus on social commerce and gamification. Skift says Hopper has "played to its strengths as a smaller, tech-led challenger brand."

AI CONSIDERED A BENEFIT, BUT NOT YET A PRIORITY, BY TRAVEL INDUSTRY PROFESSIONALS

SOURCE: *Skift*

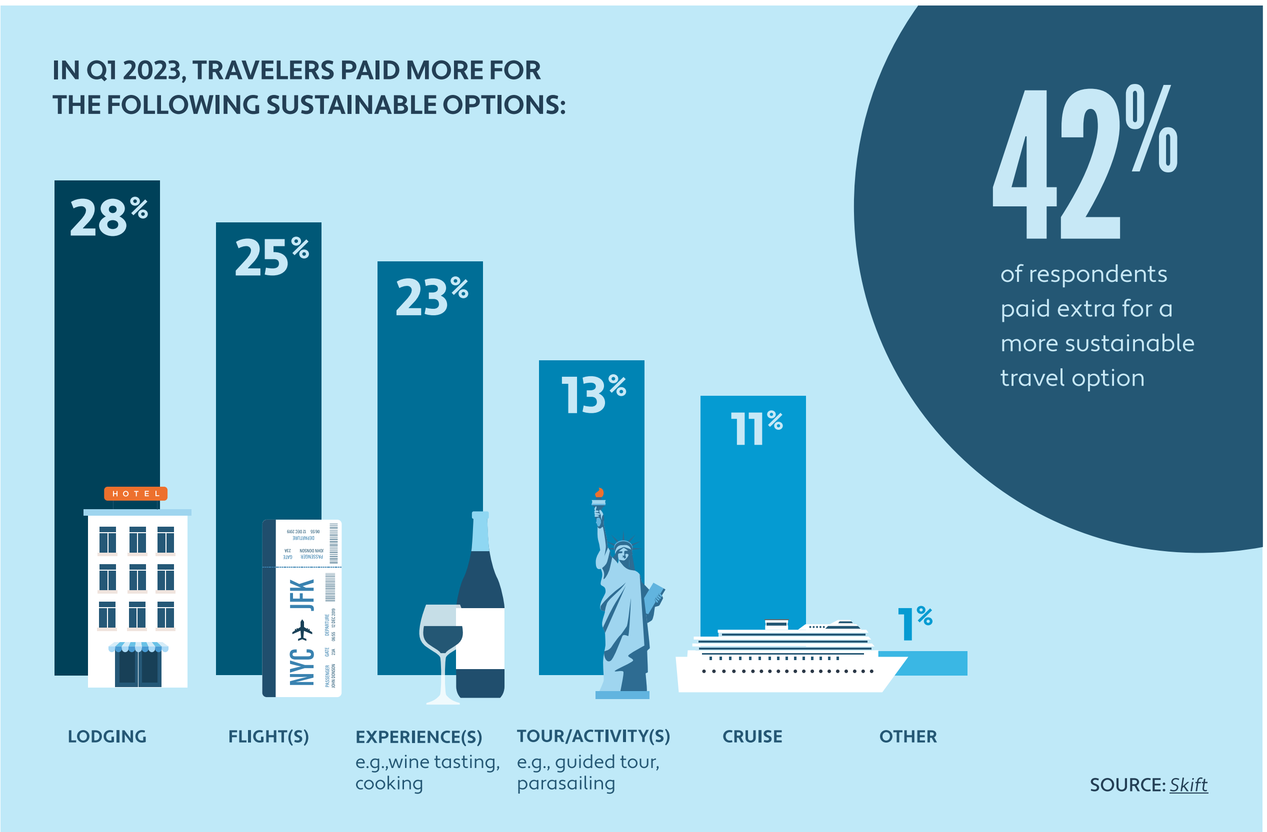


TOURISM WILL HELP COMMUNITIES REBUILD IN THE WAKE OF TRAGEDY

Maui County Mayor Richard Bissen is **urging tourists to visit the rest of Maui** while West Maui rebuilds itself after the devastating fires of August 2023. Perhaps more surprising, the State Agency for Tourism Development of **Ukraine is "promoting travel internally** and working with international tourism businesses to support its recovery." In short, tourism dollars are sorely needed.

SUSTAINABILITY WILL CONTINUE TO MATTER (ESPECIALLY IF THE PRICE IS RIGHT)

Of the U.S. travelers surveyed by Skift Research in Q1 2023, 42% paid extra for a more sustainable travel option during the past 12 months. And 28% of those respondents paid more for a sustainable hotel or other accommodation. This is true for business travelers as well: 63% of surveyed U.S. companies, on average, are interested in increasing sustainable business travel, even if it costs more.



But Skift Research's Travel Tracker found that some people are only willing to pay so much for their principles. Of those surveyed:

- 25% of travelers claim sustainable travel options are too expensive
- 38% are willing to pay up to 5% of the travel product price for a sustainable option

There could be an opportunity here for businesses. Skift Research's U.S. Travel Tracker findings suggest that a majority of survey respondents didn't find any website messaging around sustainable travel. Providing more information about sustainability practices (if you have them) could help you stand out.

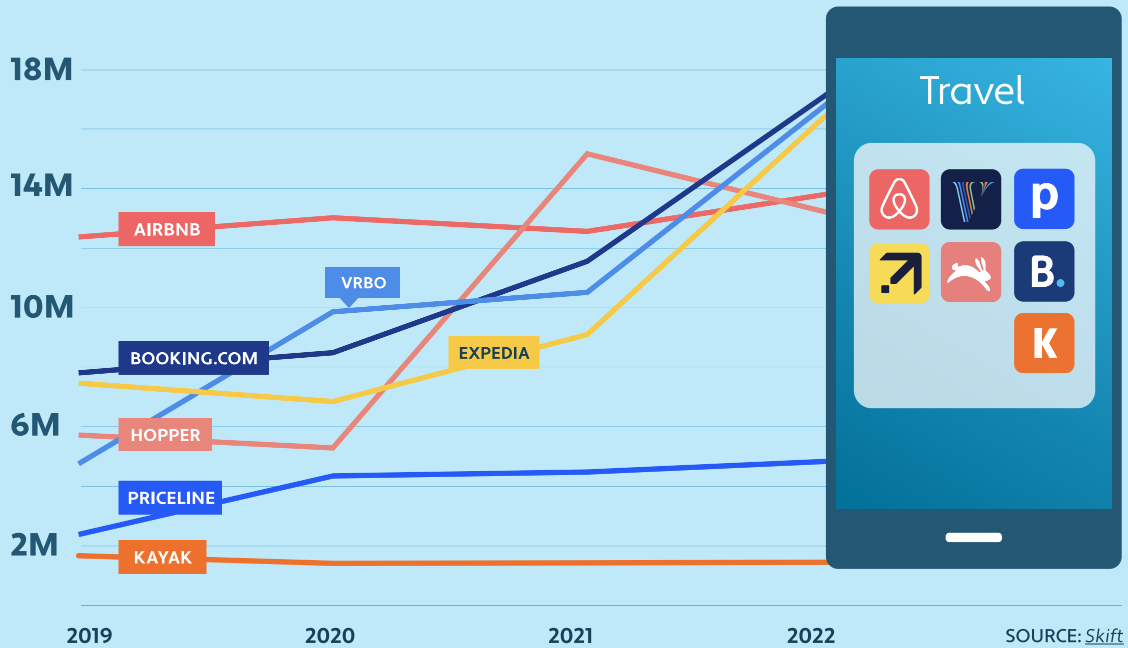
MORE BOOKINGS WILL GO MOBILE

Mobile bookings tend to lag behind desktop bookings in the U.S., but they're on the rise. Expedia Group reports that the booking share on phones and tablets increased **15%** between 2019 and 2022. Similarly, mobile app search share in 2022 was 30% higher than in 2019.

That certainly isn't everything, but it gives you a good idea of what's affecting the lodging industry.

MOBILE BOOKINGS IN THE U.S. ARE ON THE RISE

U.S. annualized app downloads



SOURCE: *Skift*

How Avalara can help

Avalara can help you account for tax changes and improve tax compliance for your business. Learn more about our automated solutions for tax research, calculating tax rates, preparing returns, and managing documents.

HOSPITALITY BUSINESS SOLUTIONS

SHORT-TERM RENTAL SOLUTIONS

Discover more tax changes in our industry sections.

UP NEXT: BEVERAGE ALCOHOL

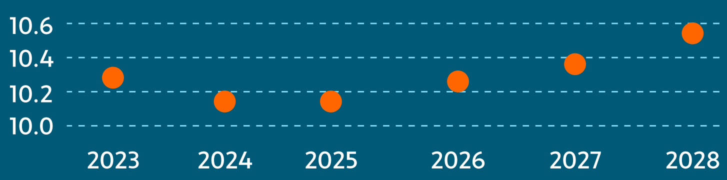
Beverage alcohol

The beverage alcohol industry is experiencing both highs and lows. Changing consumer preferences and drinking behaviors are boosting sales of certain products while other markets are declining. Yet even in the face of economic pressures, environmental threats, and a continually evolving regulatory landscape, the sector is expected to find success.

Beverage alcohol

$10.54B

U.S. ALCOHOL TAX REVENUE FORECAST BY 2028



SOURCE: Statista

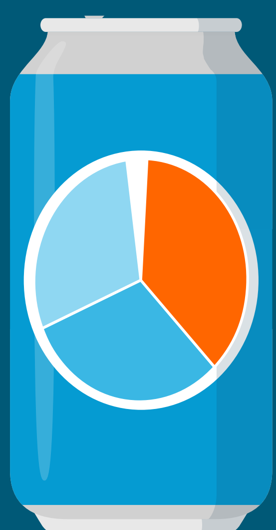
62%

of U.S. adults drink alcohol

38%

of U.S. adults abstain

SOURCE: Gallup



37%

of drinkers surveyed drink beer most often

31%

prefer liquor

29%

prefer wine

SOURCE: Gallup

31% BY 2024

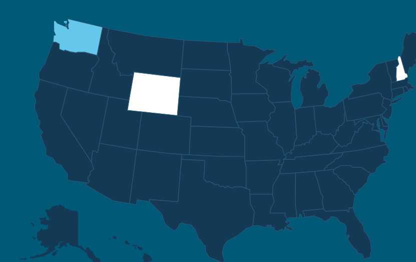
EXPECTED GLOBAL MARKET GROWTH FOR LOW- AND NO-ALCOHOL BEVERAGES

SOURCE: Exploding Topics

WASHINGTON STATE HAS THE HIGHEST PER-GALLON TAX RATE FOR DISTILLED SPIRITS IN THE U.S. AT

$36.55

NEW HAMPSHIRE AND WYOMING HAVE NONE



SOURCE: Tax Foundation

BEVERAGE ALCOHOL

States look to refine tax policies as RTDs have their heyday

Ready-to-drink (RTD) products are swallowing more and more of the beverage alcohol market. As the industry's **fastest-growing category** in the U.S., RTDs quickly became popular among consumers looking for flavor and convenience during the pandemic. According to a **NielsenIQ 2023 study**, RTD consumption has spiked 104% in the past two years while all other alcohol segments have contracted in their percent of equivalent volume.

Hard seltzers opened the door and now account for **43% of RTD sales**. Recent years have seen many new products come onto the market, including hard kombucha, cocktails in cans, and boozy lemonade pouches that provide adults with nostalgia for the Capri Sun of their childhood.

Big brands are getting in on the action. E. & J. Gallo and Anheuser-Busch added spirit-based RTDs to their portfolios. We're also seeing partnerships between household name companies that produce beverage alcohol and mixers. Coca-Cola and Jack Daniel's teamed up in 2023 to debut canned Jack & Coke. Vita Coco and Captain Morgan came out with a line of tropical drinks. And PepsiCo and Boston Beer produced Hard Mtn Dew.

Premium RTD cocktails are helping lead growth in the segment as demand for hard seltzers levels off. The global RTD cocktail market was estimated at **$1.54 billion** in 2022 and is expected to reach $2.92 billion in 2028. RTDs accounted for a **2.8%** share of total sales on alcohol delivery platform Drizly in 2022, up from 1.1% in 2020. Comparatively, the hard seltzer category accounted for a 2.7% share of the company's total sales in 2022, down from 3.6% in 2020.

Consumers are looking for transparency in ingredients. They're also paying more. The average unit price of an RTD on Drizly grew by 9.5% from $12.60 to $13.80 within a year. Depending on where you live and buy, beverage alcohol tax can increase that cost considerably. Some states tax spirit-based RTDs at the **same rate** as straight-up spirits.

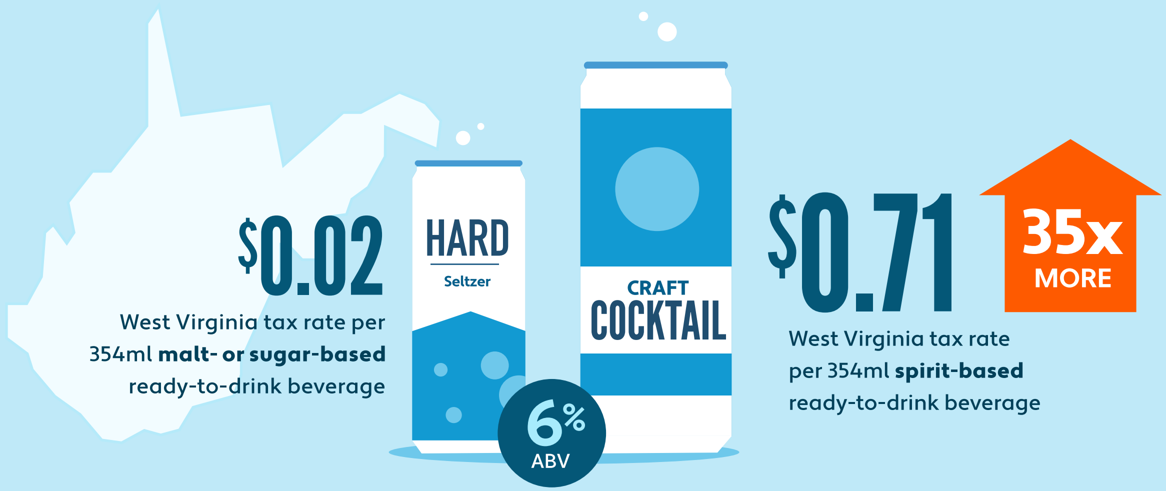
But the tax environment is starting to change. Industry advocates have been lobbying for lower taxes on spirit-based RTDs on the grounds that these products tend to have a similar alcohol content as malt-based or wine-based RTDs. At the very least, RTD cocktails usually have a much lower alcohol by volume (ABV) than distilled spirits. As one **reviewer** observed after tasting an RTD made of whiskey and ginger ale, "There's a lot more ginger ale in here than whiskey."

A **February 2023 report** from the Maryland Alcohol and Tobacco Commission examined the disparity between excise tax on spirit-based RTDs and their malt-based or sugar-based counterparts. The report notes that 25 states have a tax rate for spirit products with lower ABV that differs from the states' full-spirit rate based on ABV.

In the year prior to the report's publication, 12 states introduced legislation proposing low-proof, spirit-based, RTD cocktails be assessed at a lower tax rate than full-strength spirits. Out of these, three states enacted laws (Michigan, Nebraska, and Vermont). The other nine states rejected legislation lowering the excise tax (Alabama, Arizona, Hawaii, Kentucky, Maryland, Minnesota, North Carolina, Washington, and West Virginia). In Utah, a **citizen-led initiative** is seeking to privatize the distribution of alcohol. It remains to be seen if it will receive enough signatures to be on the ballot for 2024.

"How RTD taxes will impact sales remains to be seen. We could see suppliers inclined to do business in states with lower tax rates or where taxes are passed on to the consumer. Consumers may choose to mix their own beverages by hand instead of buying RTDs that are heavily taxed," says Oliver Hoare, General Manager of Avalara for Beverage Alcohol.

IN WEST VIRGINIA, A SPIRIT-BASED RTD IS TAXED 35 TIMES MORE THAN A MALT- OR SUGAR-BASED RTD WITH THE SAME ALCOHOL CONTENT



SOURCE: *Avalara*

BEVERAGE ALCOHOL

Wine takes a hard hit amid crowded product competition

Following 27 years of consecutive growth, U.S. wine consumption has been declining for the past three years. **Sales were down between 5% and 6%** over the previous year and a half as of August 2023. The trend is taking a toll on some wineries.

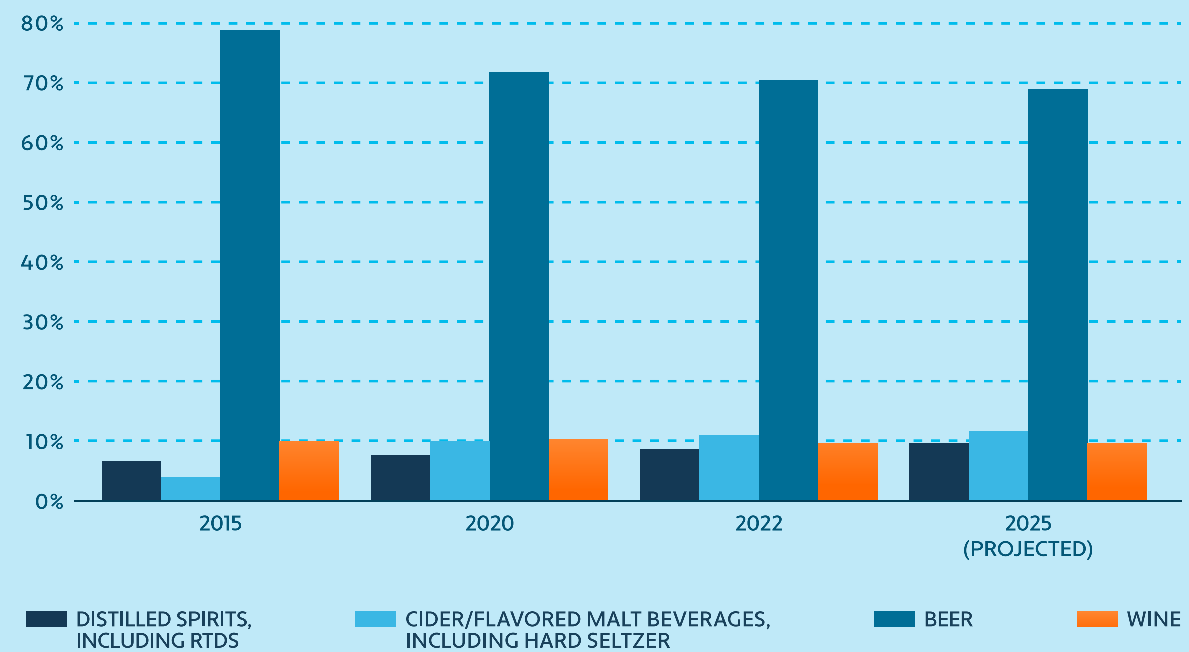
"California wineries are struggling to sell excess bulk wine and wineries are reevaluating their capital expenditure outlays for difficult economic times ahead," says Michael Dominguez, Senior Strategic Alliance Manager for Avalara for Beverage Alcohol.

Inflationary pressures along with competition from high-end spirits, craft beer, and especially RTDs are to blame. U.S. spirits consumption is projected to **surpass wine** consumption by 2025 – for the first time in over 45 years.

"The wine industry has been hard hit amid changing consumer preferences and younger consumers' tendency to drink less overall," explains Hoare.

SHARE OF U.S. BEVERAGE MARKET BY CONSUMPTION VALUE

SOURCE: *Shanken News Daily*



Research also shows consumers are **trading down in price**.

"Millennials and Generation Z are choosing cheaper wine. They don't care as much about awards and prestige," says Shannon Fahey, Indirect Tax Researcher at Avalara.

Consolidation is another trend prevalent in the wine industry, particularly during times of compression in the market. Dominguez says he's seen a large number of mergers and acquisitions in recent years as brands like E. & J. Gallo and Jackson Family Wines purchase other wineries. "We're seeing a generational shift in ownership where sometimes the new generation doesn't want to take over the family wine business either by choice or market conditions, creating good buying opportunities for well-capitalized wine businesses," he says.

Avalara experts agree that over the long term, wine will make a comeback.

"Wine is not recession-proof, but it's recession resilient," says Dominguez.

BEVERAGE ALCOHOL

Climate change continues to heat up

Changing consumer preferences isn't the only challenge the wine industry is facing. Winegrowing regions in the United States and throughout the world are being affected by climate change. Many farmers and winemakers face increased pressure to adapt their practices in response to severe weather events like droughts, frosts, wildfires, and floods.

Warmer temperatures have been a boon to certain cooler regions like **Oregon's Willamette Valley** and parts of Europe. At the same time, growers in other areas including Napa and Sonoma in California are **fearing a potential water shortage**, covering vines with shade cloths to prevent sunburn, and experimenting with grape varieties more likely to endure heat.

New research may help winemakers make decisions about how to deflect potential impacts from smoke caused by wildfires. Past years have seen some wineries refuse to release vintages due to smoke taint. The costs associated with climate change impacts can be considerable, as wineries absorb the expense of bad fruit, are unable to replant burned vineyards, and pay more for fire insurance.

It's not just grapes that are affected. The beer industry is also **turning to science** to create drought-tolerant barley varieties and monitor water supplies.

TAX CREDIT FOR SMOKE-AFFECTED WINE

Though some vineyards and wineries may opt out of producing vintages due to smoke exposure, others are experimenting with new methods and techniques to combat smoke taint in their wines. Such innovative technology may qualify for an R&D tax credit.

TECHNIQUES TO REDUCE SMOKE-RELATED AROMAS, FLAVORS, AND COMPOUNDS

VINEYARD	WINERY	POST-PRODUCTION
Hand-harvest fruit; maintain integrity of harvested fruit; exclude leaves and stalks	Minimize fermentation time on skins; cold maceration; addition of oak chips and tannins	Dilution/blending with non-smoke-affected wine; reverse osmosis/ nanofiltration of wine

SOURCE: *Wine Business*, *AWRI*

BEVERAGE ALCOHOL

Beer holds top spot as the beverage of choice

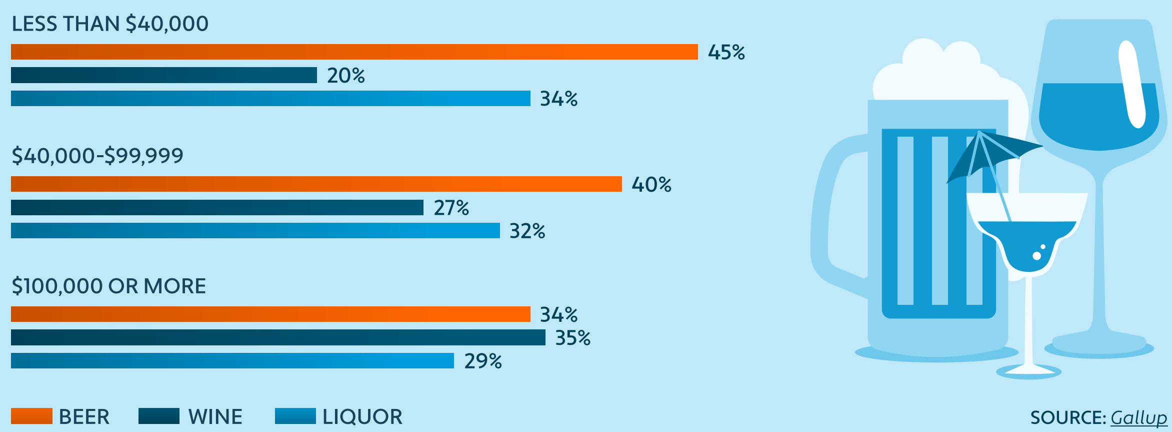
Americans, like drinkers in much of the world, like their beer. Beer remains the top alcoholic beverage of choice in the U.S. and globally, with 37% of U.S. drinkers saying they drink beer most often. U.S. drinkers in the low- and middle-income brackets are more likely to **prefer beer**, while those with incomes of $100,000 or more are more evenly divided in their preferences.

While large brewers like Anheuser-Busch InBev and Molson Coors continue to own the greatest market share, consumers' preference for craft beers and microbreweries is enhancing competition and contributing to significant growth in this sector. Many say they're looking to support small, local businesses and they're drawn to the abundance of choices and flavors that craft brews provide.

The global craft beer market is predicted to grow by $79.02 billion between 2022 and 2026, accelerating at a compound annual growth rate (CAGR) of 12.22%. Retail sales of craft beer in the U.S. increased 5% between 2021 and 2022 to **$28.4 billion**, and accounted for 24.6% of the U.S. beer market. Small and independent breweries claimed a 13.2% share of the U.S. beer market by volume.

In comparison, the U.S. beer market was estimated to be worth **$115 billion** in 2022, and overall U.S. beer volume sales in 2022 were down 3%. The Beer Institute estimated federal tax was paid on **13.2 million** barrels of beer produced and shipped in the U.S. in September 2023, a decrease of 7.4% compared to September 2022.

U.S. DRINKERS' PREFERRED ALCOHOLIC BEVERAGE, BY ANNUAL HOUSEHOLD INCOME



SOURCE: *Gallup*

BEVERAGE ALCOHOL

More consumers choosing low-alcohol and nonalcoholic beverages

Craft beer isn't the only beer segment that's growing. Nonalcoholic beer sales are up too.

Beverage alcohol companies are taking notice of a growing population that prefers to imbibe less frequently or abstain from drinking alcohol altogether. Millennials and Generation Z especially are choosing nonalcoholic and low-alcohol beverages either regularly or on occasion. Concerns about health and well-being are a main driver. Gen Zers started the **"sober curious"** trend and are drinking 20% less than other generations did at their age. A global study by IWSR shows **78%** of consumers who drink low- and no-alcohol products also drink full-strength alcohol.

Low- and no-alcohol beer, cider, wine, spirits, and RTDs grew over **7%** in volume across 10 key global markets in 2022. The category is forecast to grow at a CAGR of 7% through 2026, compared to 5% from 2018 to 2022, and achieve a market value surpassing $11 billion.

Sales of nonalcoholic beer, wine, and spirits stood at $395 million in the U.S., only 0.47% of total alcohol sales. However, the category showed year-over-year growth of **20.6%** between August 2021 and August 2022, reported NIQ.

Nonalcoholic spirits make up the smallest category but are growing the most quickly. In 2022, nonalcoholic spirit sales in the U.S. were up **88.4%** from the previous year while nonalcoholic wine sales were up 23.2%.

PERCENTAGE OF SALES OF NONALCOHOLIC CATEGORY IN 2022

1.3%
NONALCOHOLIC SPIRITS
$5.03M

13.4%
NONALCOHOLIC WINE
$52.04M

85.3%
NONALCOHOLIC BEER
$328.6M

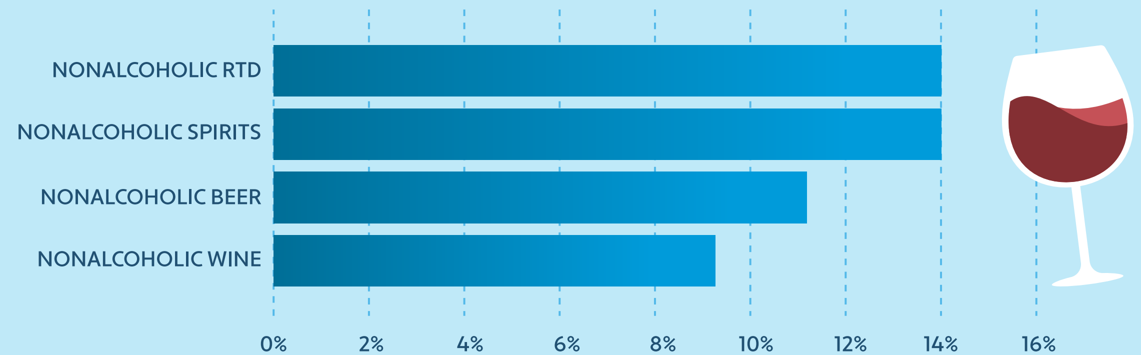
SOURCE: *Nielsen*

Nonalcoholic beer makes up the largest share of the market, claiming **85.3%** of U.S. sales in 2022. Although nonalcoholic beer **isn't growing as quickly** as spirits, some businesses have seen record success. Nonalcoholic beermaker **Athletic Brewing saw 13,000% growth** over three years.

As low- and no-alcohol beverages increase in popularity, states are looking to refine tax policies on these products. **Minnesota** introduced a bill to tax low-alcohol spirits products at the same rate as wine effective 2023 but it died in committee.

The U.K. government is taking steps to **promote** low- and no-alcohol beverages, including allowing for the labeling of drinks with 0.5% ABV as alcohol free. This is in line with other countries around the world including, Australia, Belgium, Denmark, Germany, Portugal, Sweden, and the U.S. The threshold in the U.K. is currently 0.05%.

COMPOUND ANNUAL GROWTH RATE OF NONALCOHOLIC DRINKS WORLDWIDE 2021–2025



SOURCE: *Statista*

BEVERAGE ALCOHOL

Businesses still rely on direct shipping as consumers return to stores

Direct-to-consumer (DTC) sales comprise 12% of total wine sold in the U.S., calling some industry advocates to declare DTC the "**lifeblood of the wine industry**."

"DTC sales exploded during the pandemic as consumers had their favorite beverage alcohol products conveniently sent to their homes. Now people can go into the store. They are cutting wine subscriptions and the industry is feeling it," says Oliver Hoare.

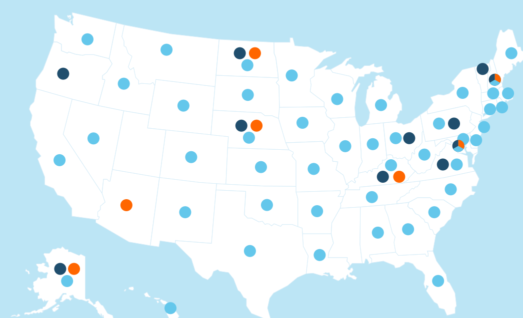
Currently, out-of-state wineries can ship DTC in most states (only Mississippi and Utah ban all DTC shipping outright, while Arkansas and Rhode Island allow on-site wine shipments, but not off-site shipments). In comparison, out-of-state **breweries** can ship to consumers in 10 states plus Washington, D.C., and out-of-state **distilleries** can ship into just six states and Washington, D.C.

California extended shipping rights for licensed craft distillers until January 1, 2025. The law permits licensed California craft distillers and distilled spirits producers or craft distillers licensed in any other state that produce no more than 150,000 gallons of distilled spirits per year to ship to California consumers.

DTC shipping remains a **key priority** of the Distilled Spirits Council of the United States (DISCUS), which hopes to level out the playing field. According to a March 2021 DISCUS survey, **80%** of consumers believed distillers should be able to ship products directly to customers in any state.

Rhode Island is in the midst of a three-tier system tug-of-war around direct shipping of alcohol. The **First Circuit refuted claims** brought by plaintiffs that just because one state has a "lesser" law does not compel another state to accommodate it.

STATES THAT CAN SHIP DIRECTLY TO CONSUMERS



BEER: Alaska, Kentucky, Nebraska, New Hampshire, North Dakota, Ohio, Oregon, Pennsylvania, Vermont, Virginia, and Washington, D.C.

SPIRITS: Alaska, Arizona, Kentucky, Nebraska, New Hampshire, North Dakota, and Washington, D.C.

WINE: All states except for Mississippi and Utah

SOURCE: *Avalara (breweries)*, *Avalara (distilleries)*

BEVERAGE ALCOHOL

Beverage alcohol looks to become environmentally responsible

Beverage alcohol businesses continue to face pressure to adopt sustainable practices. As more states push legislation to require responsible packaging and recycling initiatives, beverage alcohol businesses are experimenting with eco-friendly options. According to a 2021 survey of consumers, **73%** of respondents say they're willing to pay more for sustainable packaging; that number is even higher among younger buyers.

California enacted a law in 2022 to **expand its refundable bottle recycling fee** to wine and spirits producers and distributors effective January 1, 2024. **California's bottle fee** currently applies to beer, wine coolers, and many nonalcoholic beverages. The law doesn't just apply to glass; it also applies to box, bladder, and pouch containers. Out-of-state beverage alcohol companies that ship wine DTC to California consumers will have to pay the fee, as will out-of-state beer certificate of compliance holders and companies located within the state. Businesses will need to register as a manufacturer, distributor, or both.

California passed a **law** in October 2023 that updates the definition of "beverage manufacturer" for wine, beer, and spirits to better align with the industry. The definition is now based on what type of California Department of Alcoholic Beverage Control license a business holds, not who fills the container. Other states including **Oregon** and **Maine** have enacted bottle bills or are considering legislation.

Approximately **13 states** introduced Extended Producer Responsibility (EPR) packaging legislation in 2023, and at least three passed some type of EPR law: **Connecticut**, **Illinois**, and **Maryland**. **Colorado's EPR law** requires producers to participate starting July 1, 2025, or stop selling certain products. The United States Congress has also considered this issue with the likes of **H.R. 2821** and **H.R. 5389**.

Vermont's governor **vetoed a bill** that would have expanded the state's container deposit system and created a 15-cent fee on wine bottles. **Vermont's bottle bill** currently covers beer, liquor, wine coolers, malted beverages, and premixed spirits cocktails.

BEVERAGE ALCOHOL

Marketplace facilitator laws complicate compliance for alcohol delivery services

Beverage alcohol marketplaces and delivery services like Drizly and Vivino make it convenient for consumers to have their favorite drink sent to their doorsteps.

Uber, which acquired Drizly in 2021, continues to expand its alcohol selection. The company **announced** in August 2023 that it's partnering with midwestern grocery chain Hy-Vee, including its liquor stores.

In recent years, these businesses have realized that state **marketplace facilitator laws** apply to them and they must register to collect and remit sales tax in states where they exceed thresholds. Today, all but four states have marketplace facilitator laws, which shift the obligation to collect and remit sales tax from the seller to the marketplace platform. None of the four has a general statewide sales tax.

Drizly reached a **settlement** with the District of Columbia in November 2022 over allegations it failed to pay millions of dollars in sales and use taxes it owed, including taxes for orders processed on its platform under the district's marketplace facilitator law.

Not only do marketplaces need to understand who's responsible for tax, they also have to find ways to comply with age verification requirements for shipments. Expect marketplace facilitator laws to continue to muddy sales tax compliance for alcohol delivery services, especially as jurisdictions refine their regulations.

BEVERAGE ALCOHOL

Retail delivery fees drive up tax revenues

Delivering wine DTC to doorsteps typically involves a truck. Some states now impose a fee on wine shippers simply because a vehicle is involved in shipping.

Colorado became the first state to impose a retail delivery fee in 2022. The fee applies to tangible personal property delivered by motor vehicle to a Colorado address. That includes wine. Wineries may have to pay the fee whether they're based in Colorado or another state (assuming they've triggered nexus in Colorado).

Colorado simplified its law in May 2023. Among the changes, businesses with less than $500,000 in annual retail sales in Colorado are exempt from the retail delivery fee.

Colorado initially set the fee at 27 cents then bumped it up to 28 cents on July 1, 2023. The fee applies to each sales transaction, even if multiple orders arrive in the same shipment.

Minnesota followed Colorado's lead and will impose a 50-cent retail delivery fee starting July 1, 2024. Minnesota's fee will also apply to DTC wine deliveries in the state.

We talk more about retail delivery fees in the **sales tax**, **retail**, and **energy** sections of this report.

BEVERAGE ALCOHOL

Beverage alcohol industry turns to technology

Technology will play an important role in helping the beverage alcohol industry go with the tide and stay afloat. A 2022 **Avalara/Potentiate survey** found that 58% of beverage alcohol businesses said they were more likely to purchase new technology solutions in the next 12 months because of the pandemic, the shift to remote work, and the economic climate.

More beverage alcohol businesses are opting to automate to offset increased labor and production costs and to streamline efficiencies. Big data and machine learning are helping distilleries control flavor profiles and reduce filtration process time. **Drones are used to spray and observe vineyards**. Remote control weeders are keeping unwanted plants down. **Software-operated tractors can help farmers** remotely handle mowing and spraying. Robotics are picking up the pace on the bottling line. AI analysis tools can improve quality and **predict consumer preferences**.

Automation can also make beverage alcohol tax compliance easier. Businesses surveyed by Avalara/Potentiate spend an average of 50 hours per week on tax management and compliance. Automating areas like tax calculation, shipping verification, licensing, returns, product registrations, and tax research can save time and reduce costs.

There's still more brewing in beverage alcohol, but this is just a snapshot of the top issues affecting the industry.

How Avalara can help

Avalara tax automation solutions for wineries, breweries, distilleries, and other businesses in the industry can mitigate compliance risk. Learn more about our complete solution for licensing, product registrations, tax calculation, and filing for beverage alcohol businesses.

EXPLORE SOLUTIONS

UP NEXT: COMMUNICATIONS

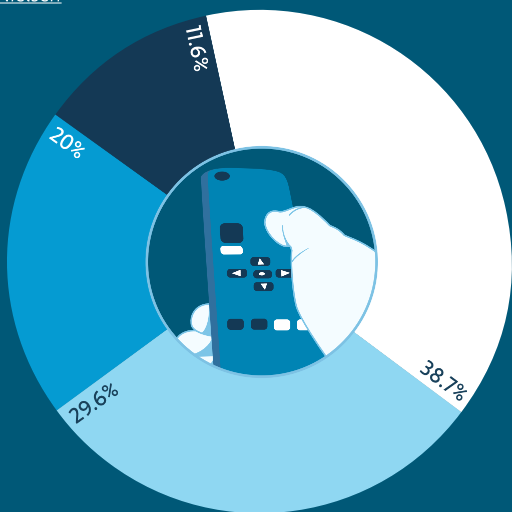
Communications

The communications industry and technology are intrinsically entwined. Both are constantly changing and the sheer volume of communications services and products makes it tough to keep track of what innovations are subject to communications tax. This is made even harder when states pass new legislation. What's obvious is that communications services are increasingly playing a bigger role in how we spend our lives and do our jobs.

Communications

Streaming's share of TV usage hit an all-time high in July 2023; streaming's share in July 2022 was 31.5%

SOURCE: Nielsen



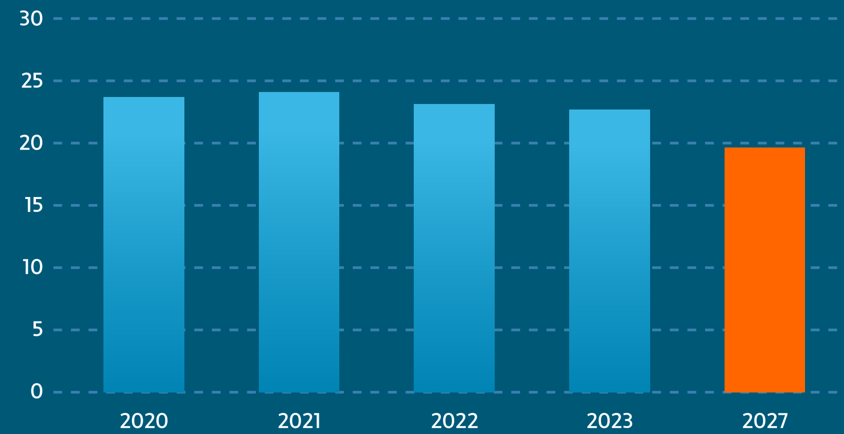
38.7% STREAMING

29.6% CABLE

20% BROADCAST

11.6% OTHER

TOTAL BASIC CABLE NETWORK GROSS ADVERTISING REVENUE ($B)



Cable TV network ad revenue is expected to drop by 4.9% in 2023 to an estimated $22.4 billion; by 2027, revenue is forecasted to fall below $20 billion

SOURCE: TV Tech

GLOBAL SUBSCRIPTION VIDEO REVENUES ARE PROJECTED TO REACH

$322B

in 2030, an increase of 145% from 2023

SOURCE: Los Angeles Times

WORLDWIDE CPAAS MARKET

$14.3B IN 2022

$29.7B IN 2026

SOURCE: IDC

75%

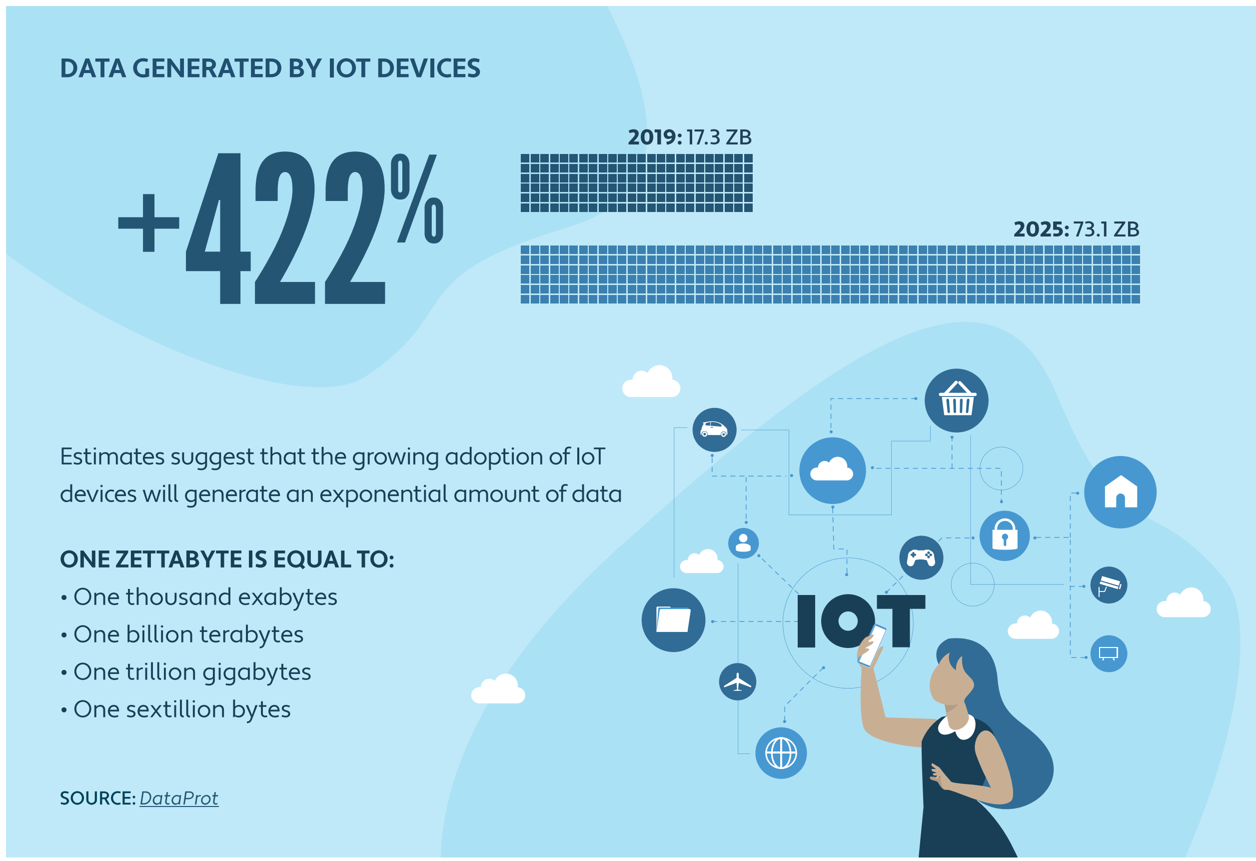
of enterprise-generated data will be created outside of centralized data centers by 2025

SOURCE: Gartner

COMMUNICATIONS

IoT, edge computing, and the expanding digital landscape

From kitchen appliances to smart pacemakers to technology that helps farmers fight crop disease, Internet of Things (IoT) devices are changing our lives and transforming the way we do business. IoT devices are used across many industries including retail, utilities, transportation, manufacturing, and government.



The number of IoT connected devices worldwide is forecast to grow to more than **29 billion** by 2030, all the while making communications tax more complicated for the businesses that manufacture them. That's because it's not always easy to know which **communications services and products are subject to tax**.

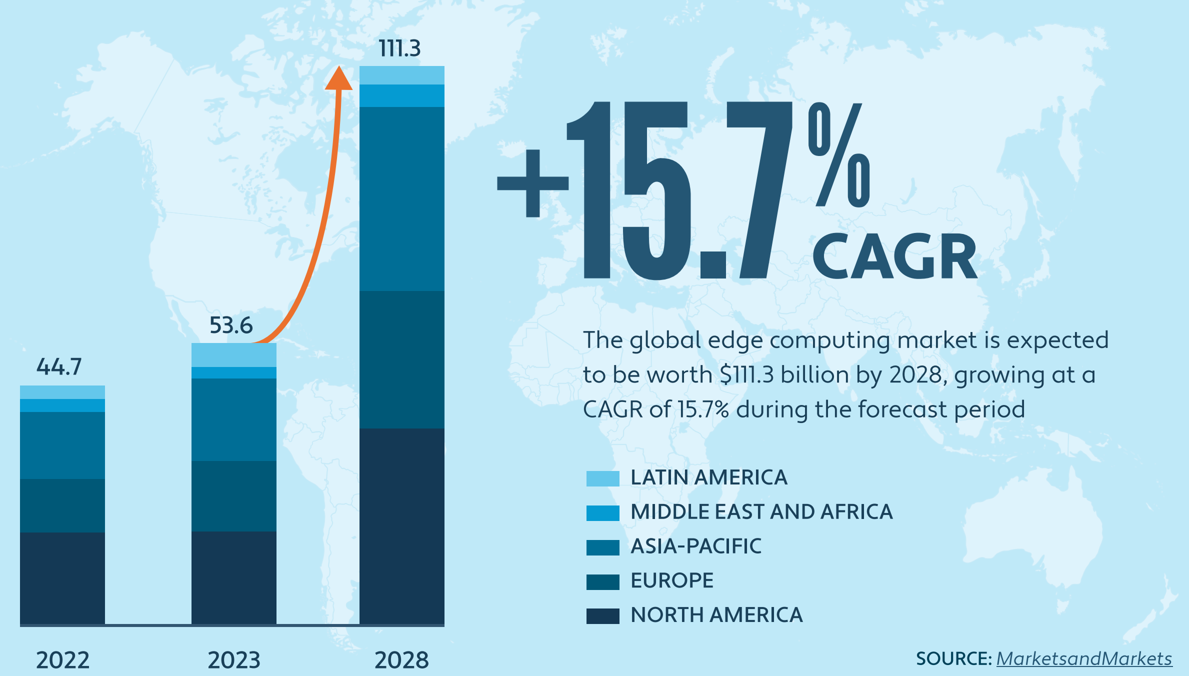
Taxing internet access isn't allowed under the **Permanent Internet Tax Freedom Act** (PIFTA). Therefore, an IoT device that simply connects to the internet may not be subject to communications tax. But consider taxability for a device that doesn't access the internet beyond transmitting data through it. The connection might meet the definition of internet service or could be classified as a wide area network (WAN) or a local area network (LAN), and taxability depends on which category it falls into.

More and more IoT devices are using AI to gather and analyze data. Estimates suggest that by 2025, IoT devices will create around **73.1 zettabytes of data**. As demand for data increases, we could see more businesses adding data centers.

As the volume of data increases, we can also expect growth in edge computing. Edge computing allows IoT devices to process data at the furthest reaches, or edge, of a business's network. This allows organizations to improve speed, save bandwidth, and only send certain data to data centers for processing.

In 2018, **Gartner** predicted that by 2025, 75% of enterprise-generated data will be created outside of centralized data centers. According to MarketsandMarkets, the global edge computing market is expected to grow from $53.6 billion in 2023 to **$111.3 billion in 2028** at a compound annual growth rate (CAGR) of 15.7%.

EDGE COMPUTING MARKET GLOBAL FORECAST TO 2028 (USD BILLIONS)



SOURCE: *MarketsandMarkets*

COMMUNICATIONS

Businesses should expect to pay as states implement 988 fees and prepare for Next Generation 911 upgrade

With our cell phones always at hand, it's easy to think emergency responders can find us anytime, anywhere. But that's not always the case.

Enter **Next Generation 911** (NG911), the newest flavor of 911 service. NG911 is a digital internet protocol (IP)-based system that will replace the analog infrastructure that's been in place for decades. It will allow 911 centers to accept text messages, images, video, and voice calls. As of 2021, the latest data available, **38 states** said they've adopted a statewide NG911 plan.

Existing 911 services include Enhanced 911 (E911), which shows the address of a traditional wired phone line. Cell phones transmit your location using a satellite chip but the equipment needed to accept satellite information is typically found only in major cities.

Despite all the changes in technology, city and county ordinances governing 911 services haven't changed much in the past 40 to 50 years. So how these laws apply to new technologies isn't always

THE EVOLUTION OF 911 EMERGENCY CALLS AND E911

SOURCE: *OnSIP*

LANDLINES

Before cell phones, the 911 system was initially implemented with landlines, meaning the address associated with each line was tied to the location of the call. Local carriers keep a database of linked phone numbers and physical addresses, which all local public safety access point (PSAP) dispatchers can access.

CELL PHONES

The invention and popularity of mobile phones challenged the system due to their geographic flexibility. They can be located either through the device's GPS receiver or through radiolocation. During a 911 mobile phone call, the wireless network provides their coordinates to dispatchers. Early on, the FCC stipulated that networks had six minutes to give the caller's coordinates within 300 meters.

VOIP

Similarly, the increased geographic flexibility of VoIP makes a call more difficult to locate during emergencies. VoIP providers enable E911 by having customers set a physical address to show up when they dial 911 on their VoIP device. For this to work, VoIP providers also have to cooperate with traditional phone companies that control access to the public telephone system (VoIP's direct competitor) and 911 operators.

clear. This can leave businesses wondering how to calculate accurate communications tax. States and other reporting jurisdictions collected 911 and E911 fees totaling **$3.49 billion** in 2021.

The Federal Communications Commission (FCC) set a July 16, 2022, deadline for telecommunications carriers and VoIP service providers to direct 988 calls and texts to suicide prevention and mental health counselors. Recently, some states have started imposing **regulatory fees in connection with 988 calls and texts** directed to the **Suicide and Crisis Lifeline**.

The new fees are likely to make an already complex landscape of communications taxes and fees even more complicated. States originally intended per-line, per-month public utility fees to be a fixed source of income. But in this day and age, defining what actually constitutes a line is fuzzy due to a myriad of new technologies. It's also possible that states don't yet know how much it will cost to implement 988 services. The new surcharges vary widely.

To stay compliant, businesses will need to have systems in place to handle the new fees and potentially increased volume of tax calculations and returns. If you provide VoIP services nationwide, for example, you probably file many communications tax returns that include 911 fees. With the addition of the 988 Lifeline, you'll likely have more returns to file. Automating communications tax calculations and returns can make complying with E911 and 988 service regulations easier.

COMMUNICATIONS

Federal Universal Service Fund remains at the forefront

At last, the FCC is whole again. The appointment of Anna Gomez as the agency's fifth commissioner in September 2023 could be the sprocket needed to turn the wheel on net neutrality. That could set in motion overhauling the Federal Universal Service Fund (FUSF) and bring relief of a substantial charge added to phone bills.

Net neutrality is the principle that all internet data should be treated the same, without favoring or blocking certain websites, platforms, or devices. The commission is looking at whether to reclassify internet service as a Title II telecommunications service, making it an essential utility. That would give the agency control over broadband.

The FUSF was created to provide phone service to rural areas, low-income consumers, schools, libraries, and health care providers. In 2011, the FCC approved using the fund to extend broadband. Currently, internet service providers aren't required to pay into the FUSF, but they might be in the future if internet service is reclassified as a necessary utility.

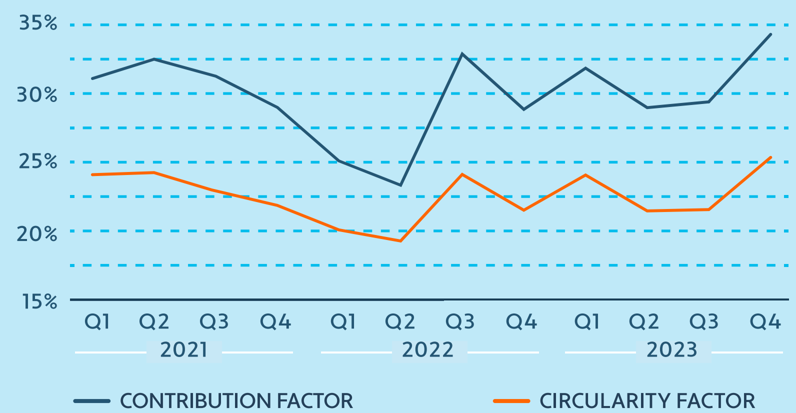
The FUSF hit a record contribution level of **34.5%** during the last quarter of 2023 and pays out almost $10 billion annually.

A nonprofit consumer protection agency is **challenging** the FUSF subsidy program, calling it unconstitutional. **AT&T CEO John Stankey** also called for FUSF reform.

"Whenever the commission does make a decision on net neutrality, it will be a front-page news story. For now, hurry up and wait. The FUSF has been lurching toward collapse for about 25 years," says Toby Bargar, Senior Tax Strategist for Avalara for Communications.

CONTRIBUTION AND CIRCULARITY FACTORS

Contribution and circularity factors are percentages used when calculating Federal Universal Service Fund obligations and annual true-up



SOURCE: *USAC*

COMMUNICATIONS

Broadband continues to dominate the internet market

More and more of us are online these days. The U.S. has one of the highest digital populations in the world, with around **311 million** internet users as of January 2023. Broadband, including cable and DSL, remains the most common type of internet access in the U.S., with **37%** of Americans saying they access the internet this way.

The largest cable and wireline phone providers and fixed wireless services in the U.S. added **3.5 million** net broadband internet subscribers in 2022. Together, these businesses represent about 95% of the market. Fixed wireless/5G services from T-Mobile and Verizon accounted for 90% of the growth. While the pandemic saw greater volumes of new subscribers, the total number is more than any year from 2012 to 2019.

Fixed wireless internet service providers (WISPs) continue to break ground as the **fastest-growing sector** of the broadband industry. While more than 7 million U.S. customers receive internet via these antenna-delivered services, most WISPs are small and medium-sized businesses with an average of 1,200 customers. Many tax incentives are available for WISPs to build out their networks to rural and underserved areas, expanding the availability of affordable internet services.

Increasing numbers of WISPs are rolling out fiber. Many are motivated by federal and state **government funding**, while economics and consumer preference are also key drivers. However, while fixed wireless can be deployed in weeks, fiber takes considerably longer and labor shortages can add delays.

COMMUNICATIONS

Ballooning everything as a service provokes tax questions

Businesses and consumers are more connected than ever. We communicate through video chat, SMS messaging, and services available via APIs.

"Companies use a whole suite of communications technologies to provide customer marketing and customer support," says Steve Lacoff, General Manager of Avalara for Communications. "AI turbocharges that and makes it more effective. Businesses can use AI to mine customer data and generate strategies. It can help fuel growth. However, AI also requires companies to be responsive, keeping up with the pace at which they are communicating to their customers and vice versa."

The proliferation of communications platform as a service (CPaaS) is a great example of this. Companies use CPaaS to send their customers appointment reminders, purchase confirmations, and order tracking notifications. B2B software-as-a-service (SaaS) providers use CPaaS to add voice calling, video chat, and messaging into their CRM and marketing automation platforms. IDC forecasts the worldwide CPaaS market to swell from $14.3 billion in 2022 to **$29.7 billion** in 2026 at a 15.8% CAGR.

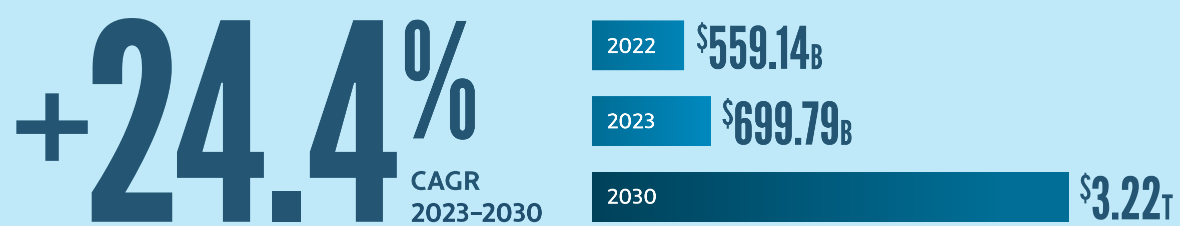
More businesses are using application-to-person (A2P) messaging to communicate with their customers. Historically, SMS has been the preferred means for reaching a wide audience. But as more customers spend time on their cell phones, brands are embracing mobile-friendly technologies like chat apps and social media apps. Business spending on A2P messaging worldwide is predicted to grow from $32 billion in 2022 to **$43 billion** in 2027.

CPaaS, SaaS, and unified communications as a service (UCaaS) are among countless cloud-based technologies complicating the communications tax landscape. Together, they're part of a huge family of technologies collectively known as everything as a service (XaaS). The global XaaS market is projected to grow from $699.79 billion in 2023 to **$3.22 trillion** by 2030 at a 24.4% CAGR.

"As these services grow, the government may conclude that internet revenues are just too significant to forgo indefinitely," says Toby Bargar. "Could tax policy changes follow? Perhaps. Policymakers could see data as a utility."

GLOBAL EVERYTHING AS A SERVICE MARKET VALUE

SOURCE: *Fortune Business Insights*



COMMUNICATIONS

Streaming gives viewers an ultimatum

As streaming companies like Netflix and Disney+ adjust to **declining growth**, consumers are being confronted with two choices: **Watch ads or pay more**.

Amazon announced it will introduce ads in Prime Video starting in early 2024 and will also offer a new ad-free option for $2.99 per month. HBO Max rolled out a lower-cost, ad-supported plan to subscribers in 2021 then rebranded the service as Max on May 23, 2023. Netflix and Disney+ launched ad-supported tiers in 2022.

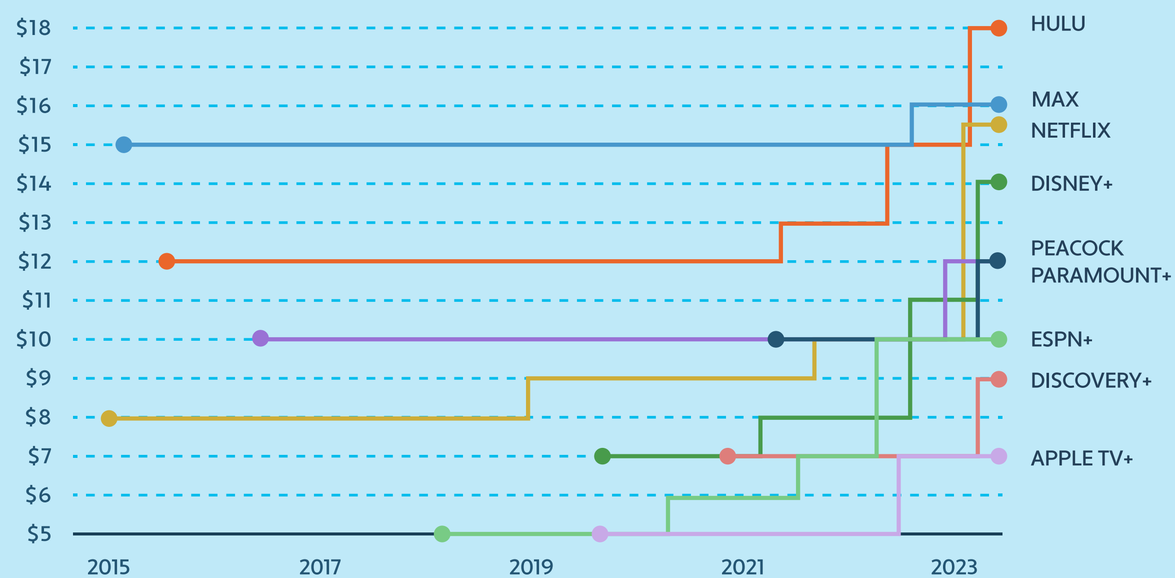
Subscription-based streamers are having to compete with ad-based services that are free to watch, like Pluto TV and Tubi.

The new plans are resonating with many subscribers. Advertising-based video-on-demand service is the fastest-growing streaming category, adding **2.6 million** subscribers during the first quarter of 2023.

Meanwhile, the cost of ad-free subscriptions is creeping up. Prices for the 10 largest streaming

LOWEST AD-FREE STREAMING PRICES PER MONTH FOR NEW SUBSCRIBERS

as of October 2023



SOURCE: *Los Angeles Times*

services increased **10%** on average in 2023. Industry watchers say this is the future. One market researcher noted that "in some cases, lower-priced, ad-supported plans have a higher average revenue per user than more expensive paid ad-free plans."

"State and local governments rely on communications taxes attached to streaming revenues to line their coffers. As revenue models change, jurisdictions may have no choice but to look at taxing ads," says Bargar.

We've already seen states propose legislation to **impose franchise fees** on streamers, as well as cities bringing lawsuits. Governments argue that because streaming companies use public facilities to deliver their services they owe franchise fees like cable providers and telecoms do.

Despite slower growth, streaming's share of overall TV usage in the U.S. hit an all-time high of **38.7%** in July 2023.

COMMUNICATIONS

What else could affect the communications industry in 2024?

6G AND 7G ARE ON THE WAY

In the world of wireless, the next great thing is always on the horizon. The sixth generation of cellular networks, 6G, is expected to be available in the **early 2030s**. Industry experts don't just expect 6G to be faster than 5G. They predict it will integrate deep learning, support IoT, and allow consumers to engage more fully with intelligent machines.

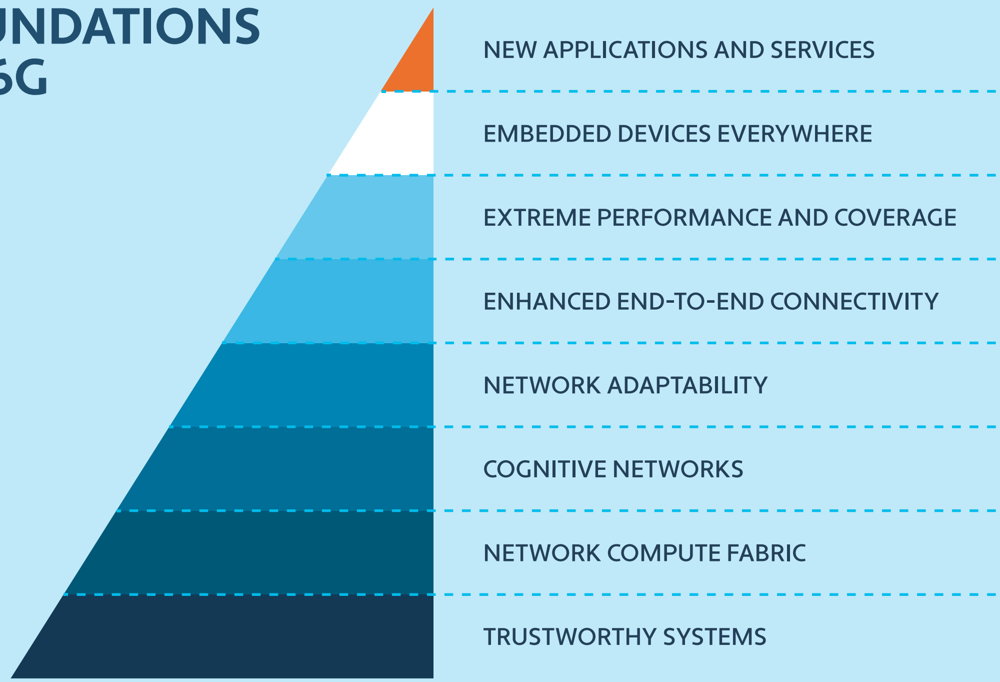
Research has already started on 7G, which offers the potential for continuous global wireless connectivity.

CONTINUED DISPLACEMENT OF TRADITIONAL INTERNET WITH WIRELESS

Cable, satellite, and internet TV providers reported losing 2.3 million customers in the first quarter of 2023, their **worst losses** to date. Now there's a new wave of cord-cutters and they're going after internet providers.

Consumers have more options for internet service and they're looking to save. For many, that means breaking free of cable internet. T-Mobile added

FOUNDATIONS OF 6G



SOURCE: *Ericsson*

557,000 5G wireless home internet customers in the third quarter of 2023, while Verizon added 384,000 customers.

Amazon launched the first satellites for its new internet service in early October 2023. The service is expected to be available to households and businesses by the end of 2024.

NEW HAMPSHIRE LOOKS TO REPEAL COMMUNICATIONS SERVICES TAX

New Hampshire Governor Chris Sununu and other lawmakers are hoping to repeal the state's communications services tax on landline phones.

The governor said taxing people's calls is "antiquated" and unnecessary. Supporters of repeal argue that communications tax is different from beverage alcohol tax, which acts as a check on a vice, and gas tax, which funds a government service.

New Hampshire has taxed telephone communications since 1990 and collects around $30 million annually, a number that has been trending downward.

What we've shared represents a small speck of what's happening in the communications industry world but we'll leave you here for now.

How Avalara can help

Staying on top of changing legislation and complying with communications tax requirements is easier with Avalara for Communications. Avalara provides a complete suite of solutions to handle calculations, file returns, and minimize risk for businesses in the communications industry.

EXPLORE SOLUTIONS

UP NEXT: ENERGY AND FUEL

Energy and fuel

What's fueling tax changes for the energy and fuel industries in 2024? Much like the 1983 Marcia Griffiths hit dance song, *it's electric*.

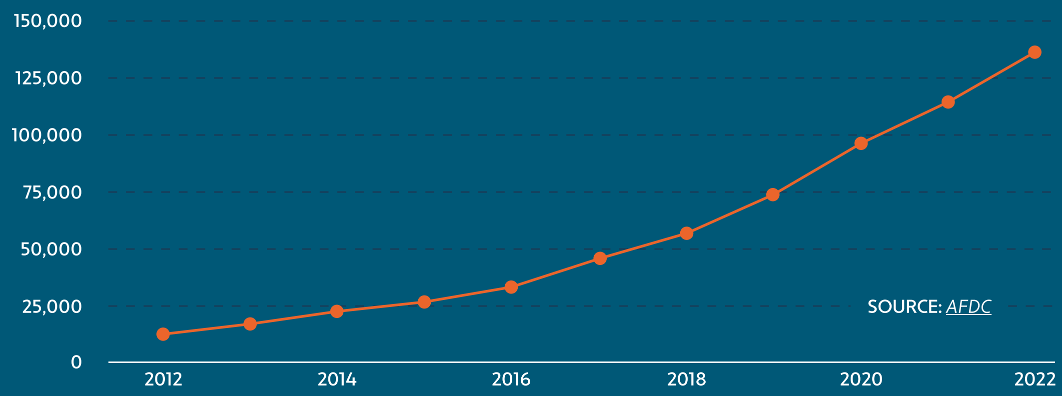
The call for climate change action is inspiring governments worldwide to mandate alternative energy solutions, which include electric vehicles and energy smart appliances. Still, some lawmakers are pushing back.

No matter what's powering the vehicles on the roads, most states agree it should be taxed. Concern over the loss of fuel tax revenue is driving states to seek alternative ways to pay for roads and highways.

And the growing market for electric vehicles means there are thousands of new jobs up for grabs at car and battery manufacturers, and states are willing to pay big bucks to be part of the electric vehicle (EV) revolution.

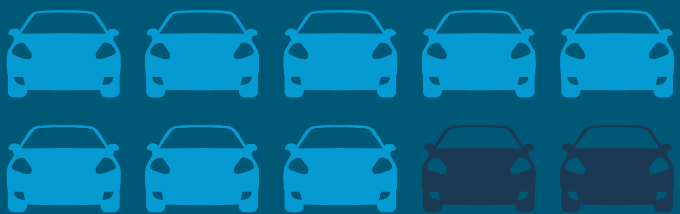
Energy and fuel

U.S. PUBLIC ELECTRIC VEHICLE CHARGING PORTS



There were about 140,000 public electric vehicle charging ports in the United States in July 2023; there should be 500,000 public EV charging stations by 2030

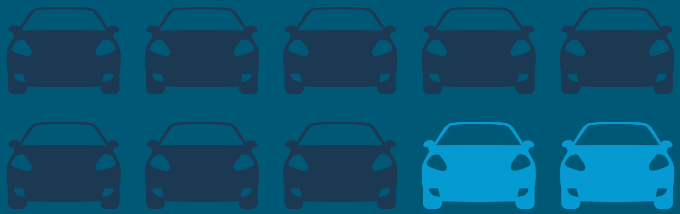
SOURCE: Route Fifty



8 OUT OF 10

passenger car sales in Norway were all-electric vehicles in 2022

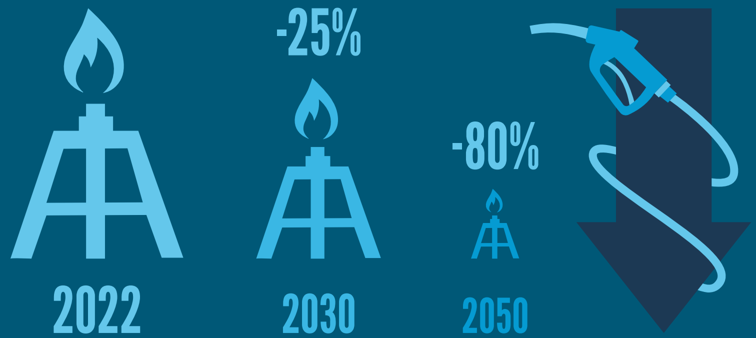
SOURCE: WRI



22%

of passenger vehicles sold in China in 2022 were all-electric

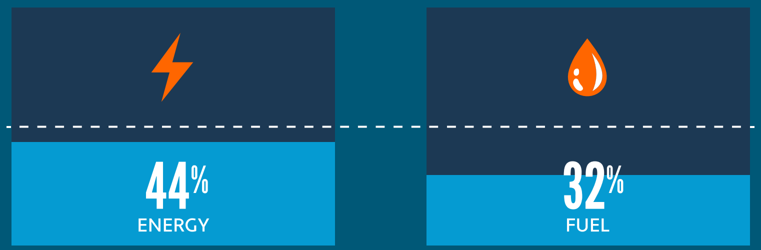
SOURCE: WRI



The IEA's updated net zero scenario ramps up clean energy capacity, which drives fossil fuel demand 25% lower by 2030, reducing emissions by 35% compared with the all-time high recorded in 2022; by 2050, fossil fuel demand falls by 80%

SOURCE: IEA

SURVEY RESPONDENTS WHOSE CHALLENGES INCLUDE MAINTAINING ACCURACY OF TAX LIABILITY CALCULATIONS



The survey also found that nearly half (49%) of energy businesses find it difficult to manage different processes for sales, use, and excise tax calculations

SOURCE: Aberdeen Strategy & Research

ENERGY AND FUEL

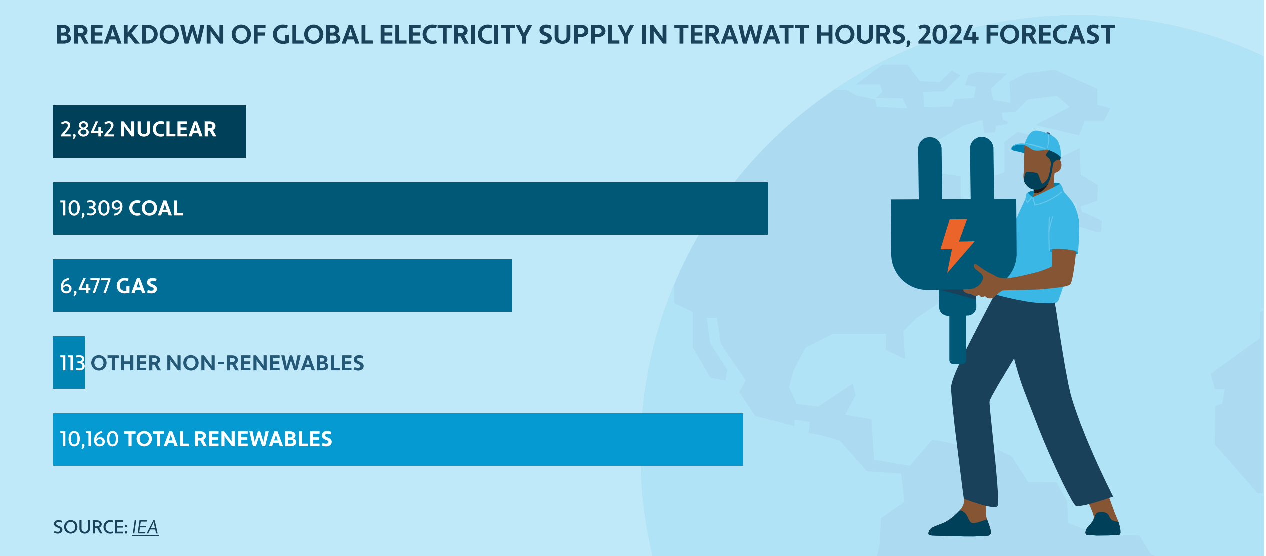
The push for clean energy

The appetite for renewable energy is expected to rise in the coming years. According to the World Economic Forum, renewable energy will account for **35%** of the power generated worldwide by 2025. And for the first time, renewable sources are predicted to **exceed one-third** of the total global power supply in 2024.

A sunny day might soon give us much more than happy houseplants and an excuse to head outside: The solar industry expects to add **32 gigawatts** of solar power production capacity in the United States in 2023.

Some of the increased demand is fueled by the Biden administration. In September 2023, the U.S. Department of Energy finalized energy efficiency standards for household appliances like gas furnaces. These new standards take effect in 2028, replacing the most recent standards passed in 2007, and are predicted to reduce carbon emissions by **332 million metric tons** over 30 years. And the **Inflation Reduction Act of 2022** allocated about $370 billion for improving energy security and clean energy transitions. Many of those funds are going toward clean **energy tax credits**, like an energy-efficient home credit and a sustainable aviation fuel credit. We can expect the IRS to issue guidance on these credits.

The International Energy Agency expects that the electricity generated from fossil fuels will **decline over the next two years**. Natural gas-fired electricity generation is expected to drop, despite a dip in natural gas prices.



SOURCE: *IEA*

ENERGY AND FUEL

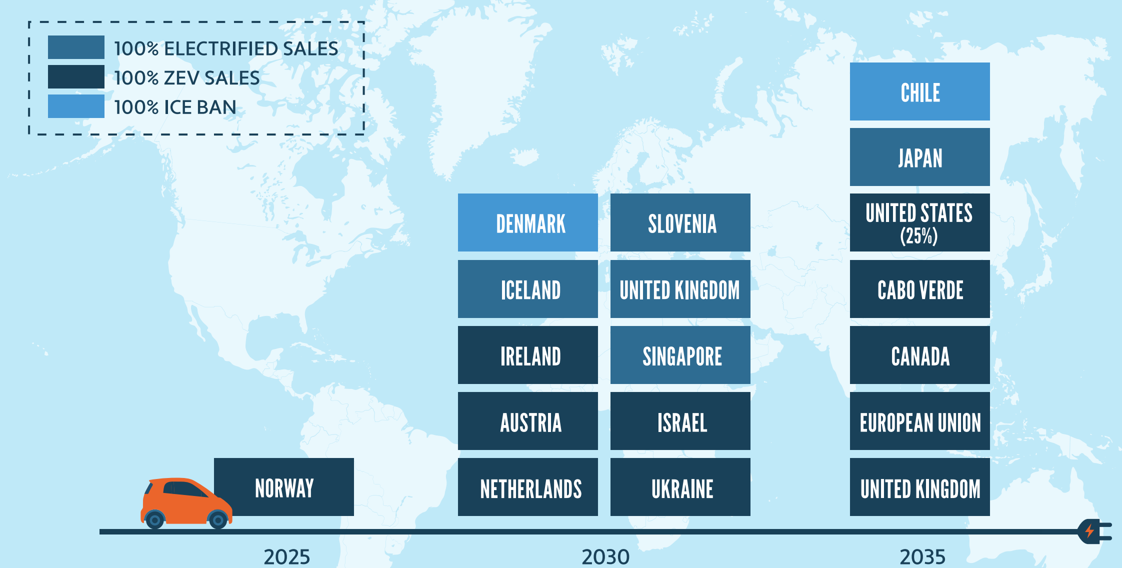
Electric vehicle mandates

Electric vehicle (EV) mandates are sweeping the globe. **Numerous countries**, including the United States and the European Union, will have 100% electric vehicle or zero-emissions vehicle mandates by 2050. For instance:

- **Norway plans** to phase out internal combustion engine (ICE) vehicle sales by 2025
- **Iceland plans** to ban new registrations of diesel and gasoline vehicles after 2030
- The United Kingdom plans for all new cars to be zero emission vehicles (ZEV) by 2035. The **ZEV mandate** requires "80% of new cars and 70% of new vans sold in Great Britain to be zero emission by 2030, increasing to 100% by 2035."

The United States also has eco goals. On the federal level, it plans for 50% of new vehicle sales to be **electric by 2030**, and to put the country "on a path to net-zero emissions by no later than 2050." California, Massachusetts, New York, and several other states are working to prohibit sales of new passenger car and light truck gasoline vehicles by 2035.

NUMEROUS COUNTRIES, INCLUDING CANADA, JAPAN, AND UKRAINE HAVE A POLICY MANDATING 100% EV SALES BY 2035 OR EARLIER



SOURCE: *IEA*

Powering all these electric vehicles will take electricity, of course, and the machines that charge such vehicles. Equal access to charging stations is essential, if challenging to provide. States are studying the issue. For example:

- **New Hampshire:** The Committee to Study Electrical Vehicle Charging for Residential Renters was created in 2023 to study accessibility and opportunities to provide electrical vehicle charging for residential renters.
- **Pennsylvania:** The House Environmental Resource and Energy Committee is considering HB 1474, which adds electric vehicle charging infrastructure projects as an eligible project type under the Pennsylvania Commercial Property Assessed Clean Energy (C-PACE) program.

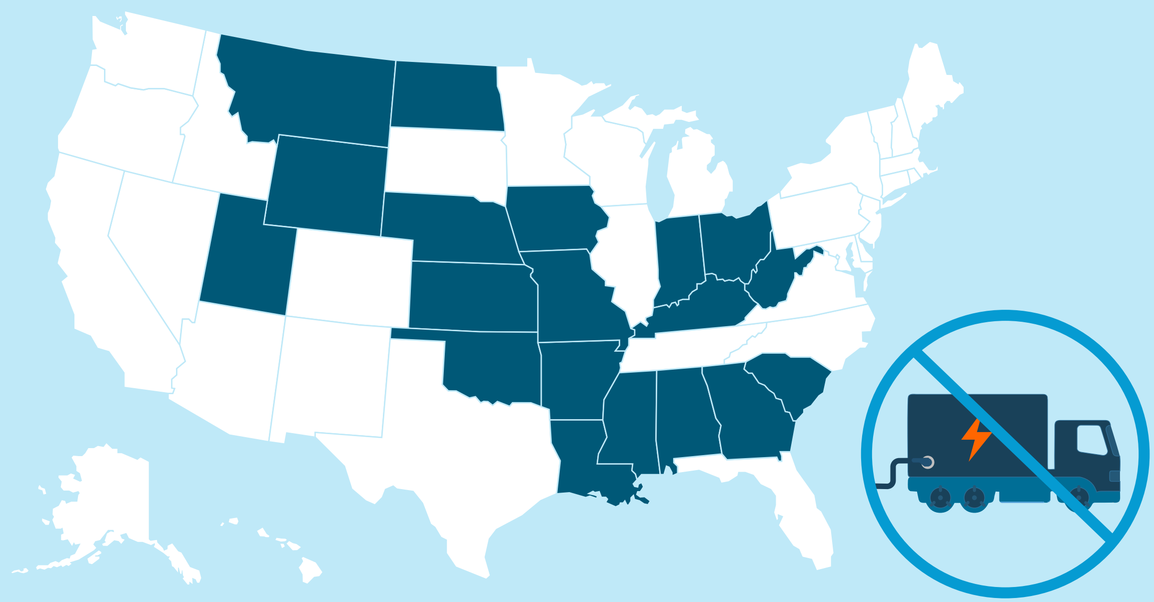
According to the **White House**, the U.S. is on track to install 1.2 million public chargers by 2030 and all 50 states, plus Puerto Rico and Washington, D.C., are participating in the National Electric Vehicle Infrastructure program (NEVI), "a $5 billion initiative to create a national network of high-speed EV chargers along major highways and interstates."

Although the federal government and numerous state legislatures are working to increase EV adoption, about **19 states** are against EV mandates. Oklahoma and **Wyoming** are actively pushing back against the proposed mandates.

GREEN TAX INCENTIVES FOR CLEAN VEHICLES

It will be easier for consumers to reap the benefits of federal clean vehicle credits beginning January 1, 2024. Under the Inflation Reduction Act, consumers can immediately lower the purchase price of a qualifying vehicle by transferring their new **clean vehicle credit** (up to $7,500) and previously owned clean vehicle credit (up to $4,000) to a car dealer.

STATES PUSHING BACK AGAINST CALIFORNIA'S EV MANDATES



SOURCE: *The Journal Record*

ENERGY AND FUEL

Fuel tax: Old fuels, alternative fuels, let's tax them all

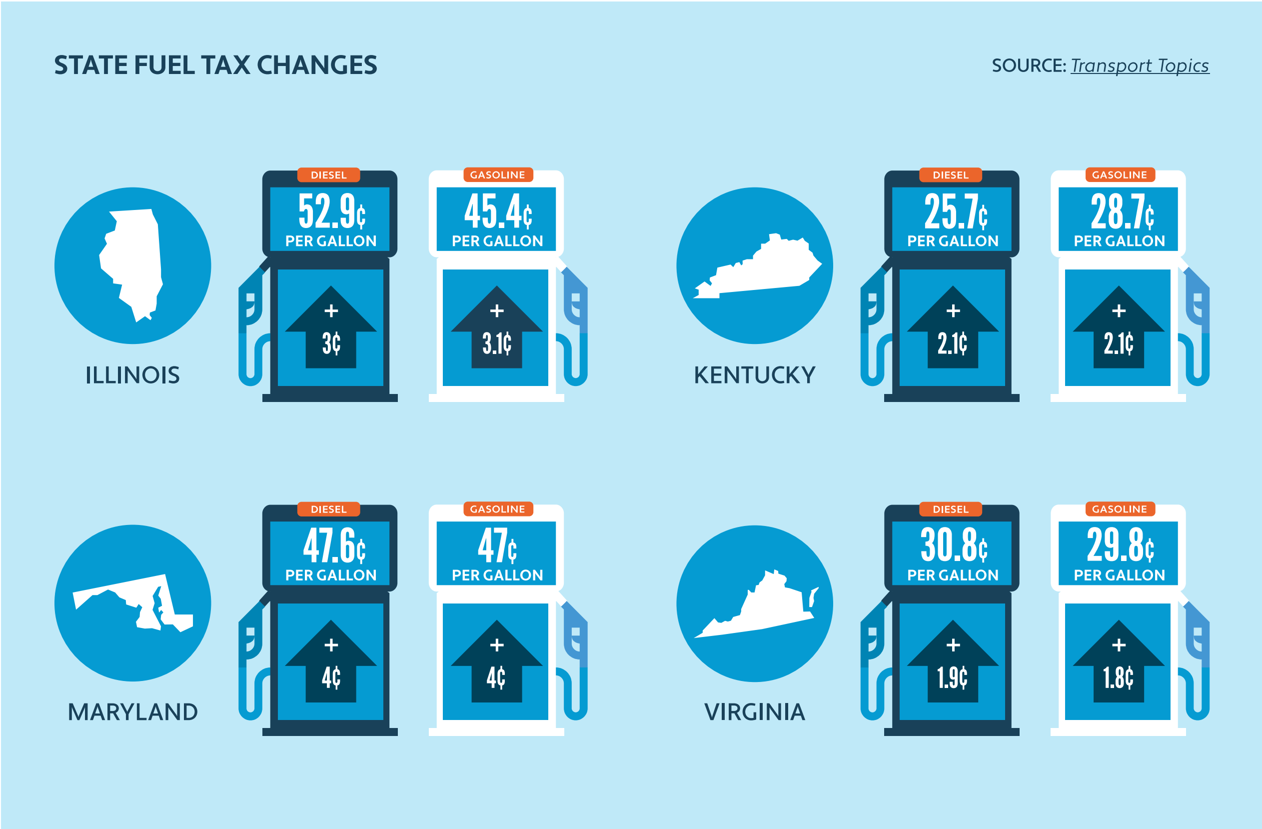
Earlier this year, **several states raised the tax rate** on gasoline and diesel. Some states are also expanding the fuel tax to include renewable energy.

In contrast, Georgia Governor Brian Kemp signed an executive order extending the state's **suspension of excise tax** on motor and locomotive fuel. The suspension remained in effect until 11:59 p.m. on November 11, 2023.

Meanwhile in California, the sales and use tax rate for diesel was lowered to 9.0625% in October 2022, but **returned to its normal rate** of 13% on October 1, 2023.

TAXING ELECTRIC VEHICLE CHARGES

There are currently about 140,000 public charging stations in the United States, which isn't nearly enough to get Americans out of their gas-powered automobiles. So, in February 2023, President Biden announced a plan to build "a convenient, reliable, and user-friendly national network of **500,000 EV chargers by 2030**." This will be critical if EVs are to



make up at least 50% of new car sales by 2030, as is the current plan.

Many U.S. roads and highways are funded by gasoline taxes, and states are concerned about losing that revenue if drivers go electric – to the tune of **[$25 billion annually]**. Some states are looking to make up for that lost revenue by taxing electric vehicles, electricity used to charge EVs, or imposing additional fees on EV purchases:

- Kentucky just passed a bill that imposes a **new excise tax** on electric vehicle power distributed by an electric power dealer to charge electric vehicles beginning January 1, 2024. There are also annual electric vehicle owner registration fees.
- Washington, D.C. is considering eliminating an **excise tax exemption** for electric vehicles passed in 2018 and taxing all vehicles at a minimum rate of 6%.
- Utah's **House Bill 301** imposes a tax on the sale of electricity used for EV charging and amends registration fees based on the weight of the vehicle (EVs tend to weigh substantially more than their gas-powered counterparts).
- Many states, including California, Michigan, Texas, Washington, and Wyoming are charging an **additional registration fee** for electric vehicles.

Perhaps those states looking to fund roads and highways could take a few pages from Europe's books. While car-per-capita rates in larger European countries are, for the most part, significantly lower than in the United States (908 cars in the U.S. per 1,000 people versus 668 cars per 1,000 people in France), the European Union uses taxes to reduce reliance on motor vehicles. In Amsterdam, drivers pay a value-added tax (VAT) of 21% on their car purchases, a one-time tax dependent on a vehicle's CO_2 emissions, and a road tax based on the vehicle's weight, type, and fuel need. Plus countries like the Netherlands and Spain levy high fuel taxes.

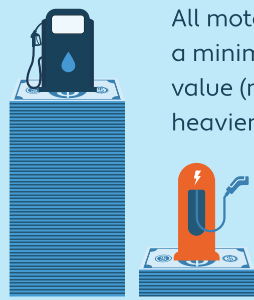
TAXING MILES TRAVELED

As EVs increase in popularity and gas tax coffers dwindle, it's clear states need to find another source of income. Some states have even piloted a **vehicle miles traveled (VMT) tax**; Oregon permanently instituted a VMT fee in 2015 that allows drivers to opt in and pay 1.8 cents per mile and get a credit against gas taxes paid. Not to be outdone, Oregon's neighbors to the north in Washington state's transportation commission are recommending a **VMT of 2.5 cents per mile** through a voluntary program to begin in 2025. Other states with voluntary VMT fee programs include Hawaii, Utah, and Virginia.

DIESEL AND GAS TAXES IN EUROPE

After extreme energy price increases in 2022, many European countries established temporary fuel tax reductions. European gas and diesel taxes have mostly gone back to pre-Russia-Ukraine war rates. Taxes on gas and diesel continue to **press public policy** throughout Europe. As the European Union, like the United States, makes environmentally conscious public policy changes, fuel tax changes will likely be central to policy discussions.

WASHINGTON D.C.'S PROPOSAL TO ELIMINATE THE ELECTRIC VEHICLE EXCISE TAX EXEMPTION



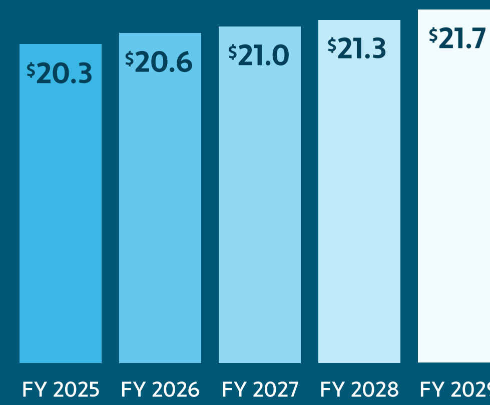
All motor vehicles would be taxed at a minimum rate of 6% of fair market value (retaining higher rates for heavier, less-efficient vehicles).

Optionally, an EV tax credit would be provided against the excise tax of up to $1,500.

SOURCE: *ORA*

PROPOSAL'S NEW REVENUE ESTIMATE

IN MILLIONS



ENERGY AND FUEL

Where you build them matters: Race to win EV factories

Someone is going to have to build all of those electric vehicles, and **states are vying** to be the next home of EV manufacturing. States like Georgia, Illinois, North Carolina, and Michigan are offering land, tax breaks, and other incentives to lure new factories from existing companies and EV startups.

- General Motors and battery manufacturer Ultium Cells announced in January 2023 that they would spend $7 billion to build electric vehicles in Michigan. The Great Lakes State in turn is giving $824 million in incentives, including grants, tax breaks, and electric grid upgrades.
- Georgia is becoming a capital of EV manufacturing with a new $5 billion Rivian plant. The Peach State incentivized the American electric car manufacturer with a "mega tax credit" of $5,250 per job for five years, workforce training, and a new highway interchange near the project.
- Oklahoma will be home to the first electric vehicle factory from startup Canoo, thanks to about $300 million in incentives like land and infrastructure improvements.
- Illinois, Kansas, and North Carolina are all bidding to be the next homes to battery and EV factories, and are offering tax breaks and other incentives.

ENERGY AND FUEL

Superfund updates

President Biden's **initial Fiscal Year 2024 budget**, introduced in March 2023, provides more than $350 million for the Superfund program to clean contaminated land and respond to environmental emergencies and natural disasters. An estimated $2.5 billion in Superfund tax revenue would also be available to the Environmental Protection Agency (EPA) in 2024. Total budgetary resources for the Superfund program would be approximately **$2.9 billion** in 2024, considerably more than the $1.7 billion available in 2023.

But that was then. As happens all too frequently, the proposed **budget wasn't approved** when the new federal fiscal year began on October 1, 2023.

THE PRESIDENT'S BUDGET INVESTS IN CLEANING CONTAMINATED LAND

$350M
FOR EPA'S SUPERFUND PROGRAM

$20M
FOR THE ALASKA CONTAMINATED LANDS PROGRAM

$2.5B
IN SUPERFUND TAX REVENUE AVAILABLE TO THE EPA

$2.9B
TOTAL BUDGETARY RESOURCES FOR THE SUPERFUND PROGRAM IN 2024, UP FROM $1.7 BILLION

$215M
FOR EPA'S BROWNFIELDS PROGRAM

SOURCE: *EPA*, *The White House*

ENERGY AND FUEL

Retail delivery fees can close the fuel tax gap

Colorado has one in effect, **Minnesota** will have one effective July 1, 2024, **New York** tried to get a retail delivery fee (RDF) enacted last year, and other states, including **Washington**, are exploring the idea. These fees tend to apply to deliveries of taxable items made via motor vehicle and are another creative way states are making up for fuel tax revenue shortfalls. Learn more about retail delivery fees in the **retail section**.

Qualifying retailers licensed to make sales in Colorado must collect the 28-cent fee on all deliveries made by motor vehicle to a location in Colorado that include at least one item of taxable tangible personal property in the shipment.

This includes, but isn't limited to:

- Brick-and-mortar retailers
- Ecommerce sellers
- Florists
- Grocery stores
- Restaurants

SOURCE: *CDOR*

ENERGY AND FUEL

What else could affect the fuel and energy industries in 2024?

Catalytic converter theft is a big problem across the country, and the Golden State is aiming to **put a stop to it** with a proposed bill that allows law enforcement to charge people with illegal automobile dismantling if they're caught with nine or more stolen converters. While the obvious benefits of this suggested bill are economic, it could have the added benefit of reducing air pollution in California.

Texas is fighting crime when it comes to the unlawful acquisition of motor fuel with **House Bill 3651**. This bill amends provisions related to motor fuel taxes and makes it easier for prosecutors to charge criminal activity. It also broadens the definition of "motor fuel" beyond those products that power gasoline and diesel engines.

The Lone Star State is also exempting nonprofit food banks from motor fuels taxes. Texas **House Bill 3599** exempts nonprofit food banks from having to pay motor fuel taxes on purchases for a vehicle owned by the nonprofit food bank and used to deliver food. It also entitled nonprofit food banks to claim a refund for any taxes paid for gas and diesel used in a qualifying vehicle.

No matter how the fuel and energy industries shift over the next year, you can count on us to track tax changes and help you gauge what they mean for your business.

How Avalara can help

Excise tax compliance is challenging for businesses in the energy and fuel sector because excise taxes vary by state and can change quickly. Avalara energy industry solutions can help you create efficiencies and reduce audit risk.

UP NEXT: GLOBAL TAX

Global tax

Though tax compliance rules differ around the world, the use of technology to implement and enforce them is becoming universal. As countries embrace the digitalization of tax, cross-border companies must keep up with e-invoicing requirements, changes in ecommerce compliance, and the latest VAT updates, all while maintaining focus on the sustainability of their business.

GLOBAL TAX

Introduction

The unrelenting growth of ecommerce – and technology that can help facilitate it – puts buyers and sellers all over the world within reach of each other. Borders, oceans, and airspace that separate them are effectively eliminated at the browsing and buying stage. An enormous amount of goods still have to get from point A to point B, and are constantly moving across borders via land, sea, and air. Cross-border compliance challenges therefore remain, as do physical borders where customs checks are conducted by humans (for now).

Technology continues to be adopted and utilized by businesses and authorities alike to help them ensure borders aren't barriers. Global tax authorities are ramping up their efforts to go digital (or at least outlining strong intentions to do so) and embrace technology, perhaps as much as businesses and customers, to make international trade easier. By digitalizing tax compliance and administration, governments can also save on costs, reduce tax fraud, increase their efficiency, move closer to global standardization, and enhance their data analytics and insight capabilities. Requiring use of e-invoicing and live reporting allows governments and authorities to achieve all of those goals.

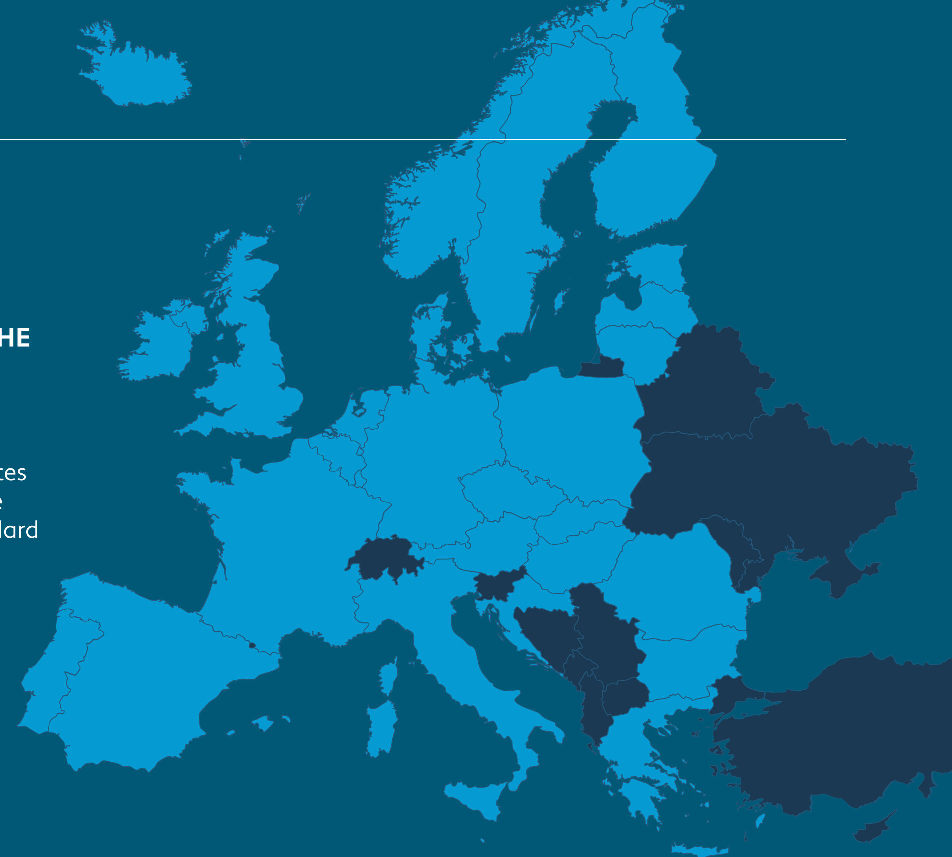
With the growing number of government mandates, and its increasing popularity among businesses, e-invoicing is central to the future of tax compliance. Governments welcome the opportunity e-invoicing and live reporting provides in gaining granular and more accurate views into transactional data in real time.

Many governments are also implementing digital hubs and systems that simplify and expedite cross-border trade without compromising national and international security – a critical factor given the current geopolitical climate. The European Union's (EU) **customs data hub** allows businesses to disentangle the administrative side of importing goods. This enables the EU to accommodate faster customs clearance without having to cut back on safety and security checks and resources.

This shift (or acceleration) into the digitalization of tax compliance suggests global governments and tax authorities are no longer simply trying to keep up with businesses' use of technology. Having a sound understanding of the essential role technology plays in international trade and compliance, governments are now setting the pace themselves instead of belatedly reacting to developments in technology and how global business is conducted.

Whether located in or outside the U.S., businesses that already do or plan to trade internationally need to understand how technology and international tax compliance are driving each other to evolve, and how the right software can help them adapt to and comply with new rules and requirements.

Global tax



G20 MERCHANDISE EXPORTS

+2.2% Q1 2023

-3.1% Q2 2023

SOURCE: OECD

COUNTRIES FOLLOWING THE IMPLEMENTATION OF THE E-INVOICING DIRECTIVE

27 EU member states comply with the European Standard on e-invoicing

4 additional European Economic Area countries

SOURCE: European Commission

AMAZON SALES ON INTERNATIONAL MARKETPLACES (USD)

$29.7B Q2 2023

$27.07B Q2 2022

$30.72B Q2 2021

$22.67B Q2 2020

SOURCE: Marketplace Pulse

WORLDWIDE RETAIL ECOMMERCE SALES ARE PREDICTED TO RISE

$5.784T (USD) IN 2023

+8.9%

SOURCE: Insider Intelligence

63% of global companies surveyed have made e-invoicing and real-time reporting a top priority

10% of businesses surveyed have a truly global e-invoicing solution in place

SOURCE: Avalara

GLOBAL TAX

The EU ramps up efforts to bring VAT into the digital age

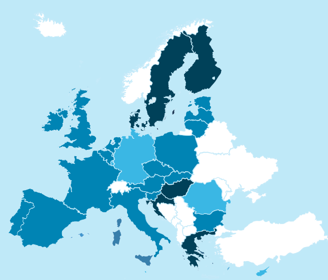
As a response to the growing digital economy – and existing VAT systems' struggles to keep up with the huge amount of online transactions – the European Commission published a proposal for **VAT in the Digital Age (ViDA)** in December 2022 – a plan to modernize VAT within the EU. The European Commission recognizes that digitalization can create opportunities to increase compliance, reduce the VAT gap, and simplify tax compliance and reporting for businesses. This major policy initiative focuses on three topics related to VAT, digitalization, and new innovative business models.

ViDA is designed to level the tax playing field for all businesses operating within the EU. Changes that go into effect will impact e-invoicing, ecommerce sellers, and the platform economy. ViDA also aims to close the VAT gap – the estimated difference between expected VAT revenue and actual VAT revenue collected. (More on closing this gap later.)

Under ViDA, it will be easier for EU member states to mandate e-invoicing owing to the **removal of legal hurdles** to mandate requirements. Existing EU VAT directives that place restrictions on EU member states whereby they must seek approval from the European Commission before mandating e-invoicing, and permission from customers before replacing paper or PDF invoices with e-invoicing, will be reformed.

ViDA will also extend VAT obligations for marketplaces and ecommerce platforms by making them liable for charging and remitting VAT when they facilitate business-to-business (B2B) and business-to-consumer (B2C) sales of goods within the EU. This will apply to domestic and cross-border sales, regardless of where the seller is based, and will simplify VAT obligations for buyers at the same time.

Also, short-term rental providers such as Airbnb and passenger transport service companies like Uber will be deemed suppliers, meaning they'll also be responsible for collecting and paying VAT for their third-party sellers or customers. This aims to bring VAT obligations for these types of businesses in line with those of more traditional service providers.



2023 VAT RATES IN THE EU

SOURCE: *Tax Foundation*

24–27%: Croatia, Denmark, Finland, Greece, Hungary, and Sweden

16–19%: Cyprus, Germany, Luxembourg, Malta, and Romania

20–23%: Austria, Belgium, Bulgaria, Czech Republic, Estonia, France, Great Britain, Ireland, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Slovakia, Slovenia, and Spain

GLOBAL TAX

E-invoicing is becoming a global standard

E-invoicing is the process of creating and providing an electronic invoice in the form of structured data – instead of a more traditional paper version or a PDF sent by email – to digitally exchange invoice data between a supplier and a buyer. An e-invoice allows the recipient to automatically process incoming invoices and post the invoice data into their accounting or ERP system with minimum human involvement.

E-invoicing is rapidly becoming more and more prevalent around the world. The benefits to governments and businesses are mutual. It's the preferred method of collecting tax information by governments in an increasing number of countries. E-invoicing enables them to better tackle tax fraud, reduce the VAT gap, gain greater transparency on transactions – and therefore more insight into business and trade data – and encourages digital transformation, in line with many countries' current goals. For businesses of all types and industries, it allows for streamlined finance departments and an opportunity to revamp and update financial and accounting systems, save on time and costs, and reduce their carbon footprint by cutting back on paper usage. According to a 2019 Billentis **report**, automated e-invoicing offers cost savings of 60–80% in most cases.

Although the electronic exchange of invoice data has been practiced by businesses for decades (predating the internet), government mandates first started to appear in Latin America in the early 2000s. It wasn't until 2019 that mandates began rolling out in Europe. More than 60 countries currently have e-invoicing legislation in place, and the scope and details of requirements for e-invoicing and live reporting vary according to economic factors and transaction types.

E-invoicing mandates and live reporting requirements are constantly being introduced, amended, and updated in all global regions, making it a huge challenge for businesses and even compliance experts to stay completely up to date on the latest information and developments.

"E-invoicing is the clear direction of travel. It's important to remember that countries that don't have mandatory e-invoicing requirements now will have them in the future," says Alex Baulf, Senior Director of E-invoicing at Avalara. "And it's only the tip of the iceberg. Governments worldwide are experiencing huge benefits by mandating e-invoicing, and with new technologies and requirements being implemented every day, it's highly unlikely digital compliance developments will stop there. For businesses that want to stay ahead of the curve, it's crucial to invest in a scalable global solution that not only works today but can handle the requirements of the future."

RECENT E-INVOICING DEVELOPMENTS BY COUNTRY

France had been moving toward a July 1, 2024, launch date for e-invoicing mandates; however, the French government recently postponed the launch due to concerns around the readiness and ability of smaller businesses to adapt to such significant compliance changes. It also wants to safeguard against risks associated with a centralized system, such as that used by the Italian Revenue Agency, the Sistema di Interscambio.

The French government is considering the risk and likelihood of all e-invoicing effectively coming to a halt in the event of a cyberattack, which could cause major disruption to business and the economy. **E-invoicing in France** will be implemented in stages, with the first wave of businesses being mandated to issue e-invoices starting September 2026.

Other recent updates include:

- In **Belgium**, e-invoicing for B2B transactions is not currently mandatory, but proposals have recently been approved to **introduce** mandatory e-invoicing for domestic B2B transactions commencing January 1, 2026.
- B2B e-invoicing is not currently mandatory in **Croatia**, but the country has proposed a date of **January 1, 2026**, for a mandate covering both B2B and business-to-government (B2G) transactions.
- Mandatory B2B e-invoicing in **Germany** is planned and currently projected for **2026**.
- **Israel** has plans to introduce mandatory e-invoicing for invoices subject to VAT where the taxable base exceeds ILS 25,000, starting **April 2024**.
- E-invoicing is mandatory in **Japan** for certain transactions such as those between companies and government agencies, as well as for transactions between businesses in certain industries. Japan has also recently adopted the use of Peppol (see below for more information) and launched the **U.K.-Japan Digital Partnership** to strengthen digital cooperation between the two countries.
- **Poland's** e-invoicing mandate is now confirmed to come into force in **July 2024**.
- **Romania** has an e-invoicing mandate for B2G and certain B2B transactions (for goods listed as "high fiscal risk") in place today. It will also introduce a general B2B e-reporting mandate beginning **January 2024** and a wider e-invoicing mandate beginning July 2024.
- E-invoicing is mandatory in **Spain** for B2G transactions and is expected to become mandatory for B2B transactions as of **July 2024**. With recent public consultation and elections, this date will probably be postponed by 6–12 months.

The Peppol network (formally known as Pan-European Public Procurement Online) was originally developed to streamline business with customers within the public sector of the EU. It also became popular for document exchange among private companies. As Peppol is adopted by more and more countries around the world, it has become the most common delivery network and standard for trading partners (including governments) to send and exchange compliant e-invoices. Currently, more than 30 countries have implemented or are in the process of implementing the Peppol framework. Though most are located in Europe – including the U.K., Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Norway, Poland, Portugal, and the Netherlands – Peppol has also been adopted in Australia, Japan, New Zealand, and Singapore.

E-INVOICING IN THE U.S.

The U.S. currently has no e-invoicing mandates or live reporting requirements. However, a pilot for voluntary adoption was carried out in 2022 by the Business Payments Coalition – led by the Federal Reserve Bank of Minneapolis. The E-invoice Exchange Market Pilot aimed to design, build, and test a virtual network that will enable U.S. businesses to exchange e-invoices and establish a secure, open e-invoice delivery framework between service providers.

The **Digital Business Networks Alliance** was established in 2023 to oversee the creation and operation of a new B2B digital highway to allow businesses across the U.S., Canada, and Mexico to exchange e-invoices. U.S. businesses that wish to continue operating in or enter into international markets where e-invoicing mandates are in place (or planned) will have to comply with local regulations. U.S. businesses should strongly consider familiarizing themselves with e-invoicing software that can help them do so.

GLOBAL TAX

IOSS opens up to more businesses

The **Import One-Stop Shop** (IOSS) scheme was introduced by the EU in July 2021. The scheme makes it easier for businesses to sell into the EU by allowing them to register in a single member state to declare and pay EU import VAT on sales made to EU consumers for a goods shipment with a consignment value below €150. Businesses that use the scheme receive a unique IOSS identification number to put on all packages sent to the EU. Having assessed that the €150 threshold creates a burden to businesses, the EU proposed on May 17, 2023, to remove it, opening IOSS to more businesses that would benefit from lower compliance costs.

As part of ViDA proposals, IOSS will become mandatory for marketplaces facilitating low-value imports into the EU.

GLOBAL TAX

Closing the VAT gap

The VAT gap is the estimated difference between expected VAT revenue and actual VAT revenue collected. It's a calculation of lost tax revenue that could have been collected if all businesses were fully compliant with VAT regulations. The European Commission recently reported that EU countries lost around **[€61 billion]** in VAT in 2021, down from €99 billion in 2020.

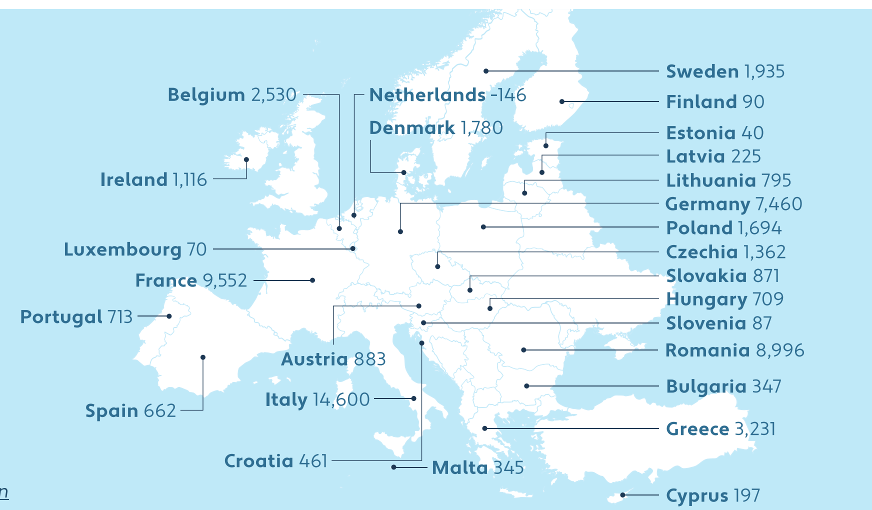
Businesses are expected to collect VAT on behalf of the government and remit it to tax authorities, but not all businesses fully comply. There are various reasons for this, from criminality such as tax fraud and tax evasion, to genuine mistakes, bankruptcies, financial insolvencies, and miscalculations and administrative errors.

The ongoing rollout and adoption of real-time reporting provides authorities with more transparency into transactional data, making it easier to clamp down on VAT fraud and evasion. By having access to vast amounts of tax data in real time, and by deploying sophisticated algorithms including artificial intelligence, tax authorities can spot unusual patterns or anomalies almost immediately, quickening their response to suspect and fraudulent activity. The understanding that transactional data is available to authorities in real time can also act as a deterrent to more evasively minded businesses, and those that "forget" to remit what's owed.

Reducing the VAT gap means governments can increase their tax revenue without raising tax rates. This can help to fund public services, healthcare, education, infrastructure, and social welfare programs.

VAT GAP IN 2021 (EUR MILLION)

27 EU countries
60,603



SOURCE: *Taxation and Customs Union*

GLOBAL TAX

Changes for ecommerce sellers

The European Commission believes **EU customs reforms** announced in 2023 represent “a smarter approach to customs checks” and “a more modern approach to ecommerce.” As part of the reforms, in March 2028, marketplaces and ecommerce platforms will become “deemed importers.” This means platforms will be responsible for ensuring VAT and customs duties – which become due when the platform receives the payment for the goods – are paid at the point of sale and removes the burden from consumers.

While VAT is applicable on all imported goods into the EU, parcels valued up to €150 are currently exempt from customs duties. This exemption will be removed March 1, 2028.

A new EU customs data hub will allow businesses that bring goods into the EU to log all information on their products and supply chains into a centralized system. Businesses will only need to submit data once for multiple consignments, instead of a declaration for each specific parcel, allowing for simplified and more rapid customs clearance. The hub will also provide relevant authorities with a 360-degree overview of supply chains and the movement of goods within the EU, as an update to risk management measures and customs checks.

The governments of EU member states will have more far-reaching access to data, and in real time. Information can also be shared among members, allowing for quicker and more unified responses to any perceived security risks. Artificial intelligence can even be used to monitor the data and predict risk before goods reach the EU, allowing EU customs authorities to channel their resources accordingly.

The reforms also include simplified tariff classifications and customs calculations to determine the customs owed for items most commonly brought into the EU via B2C sales. Though the simplified tariff treatment will be applied on a voluntary basis by importers, they’ll benefit from preferential tariff rates by doing so.

GLOBAL TAX

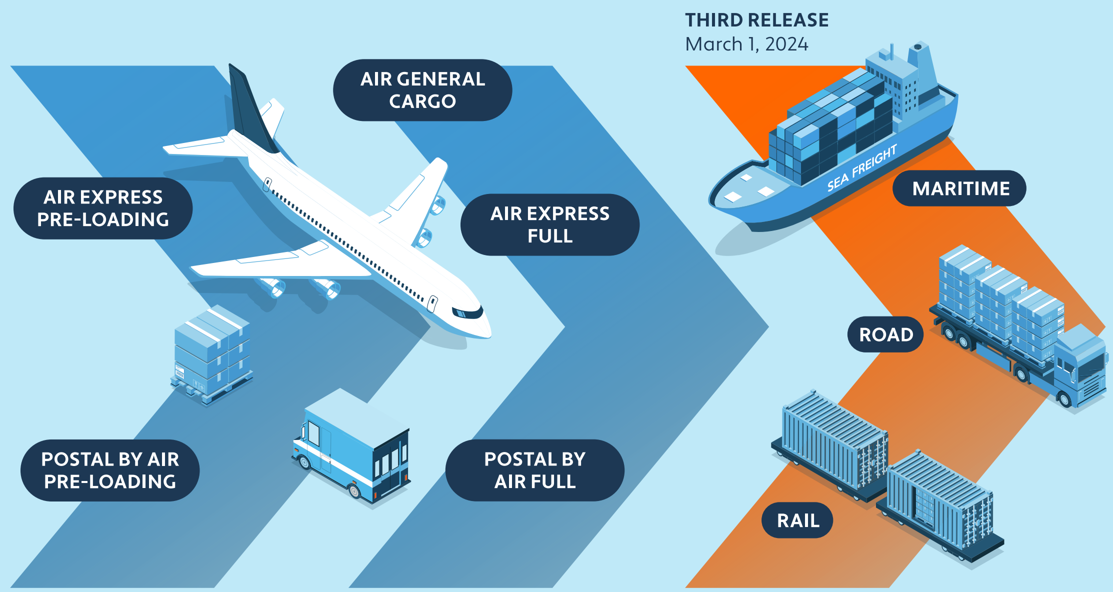
Import Control System 2 Release 3

The third and final phase of **Import Control System 2 (ICS2)** will begin on March 1, 2024. ICS2 is another EU safety and security initiative that screens shipments prior to their arrival in Europe. The initiative is designed to help protect against security and safety threats by helping customs authorities identify high-risk consignments and intervene where necessary.

ICS2 phases 1 and 2 commenced March 2021 and March 2023 respectively, affecting all carriers, couriers, and postal services transporting goods through the EU by air. From these dates, it became a requirement to submit safety and security information to the EU prior to a shipment's arrival. Without this data, goods will be stopped at customs.

Phase 3 will impose these rules on operators moving goods by maritime and inland waterways, road, and rail. All operators must submit Entry Summary Declaration (ENS) data to ICS2 prior to the arrival of goods in the EU to meet data filing obligations.

WHO IS DIRECTLY AFFECTED UNDER THE THIRD RELEASE OF THE EUROPEAN UNION'S CUSTOMS PRE-ARRIVAL SAFETY AND SECURITY SYSTEM?



SOURCE: *European Commission*

GLOBAL TAX

Free trade agreements are a boost to digital trade

The Australia-United Kingdom Free Trade Agreement entered into force on May 31, 2023, with aims of creating new export opportunities for businesses in both nations, reducing costs for businesses, easing cost-of-living pressures for consumers, and increasing transparency for customs procedures.

The agreement removes tariffs on most exports between Australia and the U.K., which the U.K. government estimates will increase U.K. GDP by **£2.3 billion per year by 2035**. Though this increase is relatively small, the government also expects the agreement "to **unlock £10.4 billion** of additional trade, boosting our economy and increasing wages across the U.K." It also cites as expected benefits: access to the Australian market for British services and investors, more opportunities for U.K. businesses to trade digitally with Australia, and lower prices for U.K. consumers and businesses.

Though multiple economic sectors are expected to see an increase in output, the agreement specifically commits to an increase in opportunities for digital trade and supports a more secure online environment for businesses in the digital economy. Governments of both nations want to enable cross-border data flows – without jeopardizing the data privacy of consumers – and facilitate the acceptance of electronic versions of trade administration documents to reduce barriers to trade. Further, the two nations are expecting ongoing cooperation on digital trade issues such as data innovation, the development and adoption of digital standards, and how emerging technologies can benefit businesses and consumers in Australia and the U.K.

The U.K. free trade agreement with New Zealand (originally signed in February 2022 and entering into force May 31, 2023) also aims to reduce barriers to trade between the U.K. and New Zealand. Like the Australia-U.K. agreement, it removes tariffs on U.K.-New Zealand trade (U.K. tariffs on some sensitive agricultural products are reduced over a transitional period). New Zealand exporters could save approximately **NZD 37 million per year** on the elimination of tariffs.

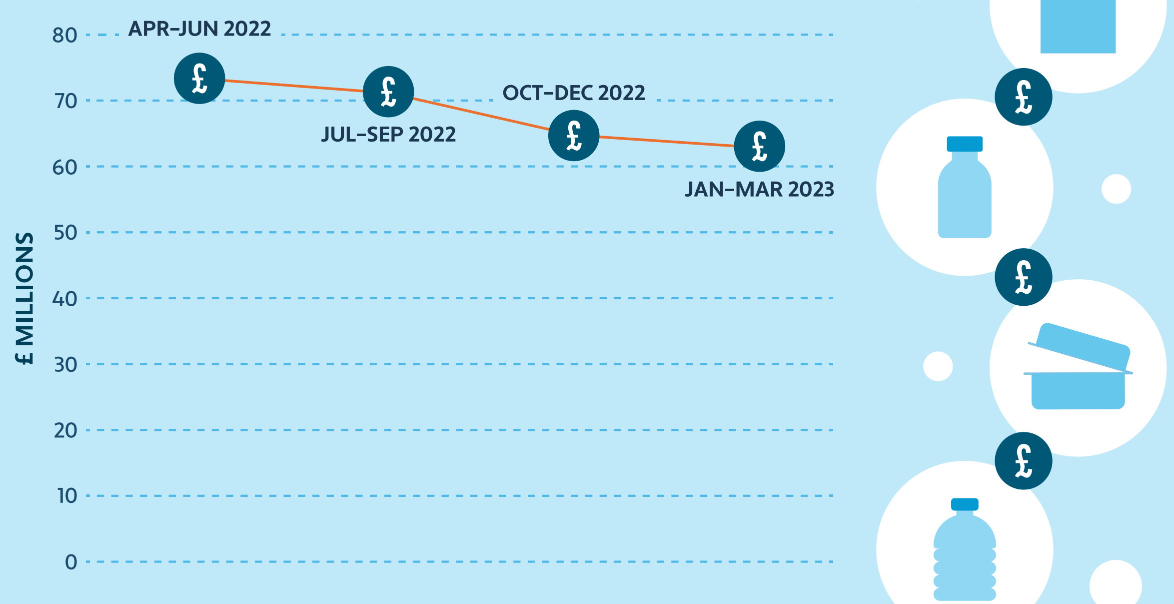
GLOBAL TAX

Sustainability

Climate issues are becoming a higher priority for nations around the world. The **Plastic Packaging Tax** (PPT) on plastic packaging with less than 30% recycled plastic came into effect in the U.K. on April 1, 2022, with a charged rate of £200 per tonne, **generating £276 million** of revenue in the first year. The rate rose on April 1, 2023, to £210.82 per tonne. PPT is designed to encourage the use of more recycled plastic and reduce single-use plastics, and applies to plastic packaging produced in, or imported into, the U.K. The U.K. government estimates the tax affects approximately **20,000** packaging producers and importers.

Businesses must submit quarterly returns to HM Revenue & Customs (HMRC) detailing weights of plastic packaging. Smaller businesses that import or manufacture less than 10 tonnes of plastic packaging per year are exempt from PPT. Once a business meets the 10 tonnes threshold, it must register with HMRC for PPT. The tax is self-assessed and businesses are responsible for ensuring they're compliant with the regulations.

QUARTERLY REVENUE COLLECTED FOR CHARGEABLE PLASTIC PACKAGING MANUFACTURED IN AND IMPORTED INTO THE UK



SOURCE: *GOV.UK*

Although HMRC hasn't announced any further PPT rate increases for 2024 or later, similar taxes targeting a wider range of materials would come as little surprise in the U.K. and beyond.

Australia – one of the world's biggest fossil fuel exporters – passed **climate laws** on July 1, 2023, requiring total emissions from big industrial sites to be cut by **5%** per year, either through absolute cuts or by buying carbon offsets. The Australian government has announced a review on whether to introduce a carbon border adjustment mechanism (CBAM) in the country – essentially, a "carbon tariff" to certain imports from overseas. The feasibility of introducing such measures is set to be determined in October 2024.

Australia has seemingly taken lessons from the **EU CBAM**, which imposes a levy on industries with significant emissions and aims to ensure the carbon content of imported goods is equivalent to those produced within the EU. The EU uses software and algorithms to analyze data on the raw materials and production and transportation process to calculate imported products' carbon footprint. CBAM data can also be integrated into customs systems for the purpose of customs checks upon import. The EU can therefore use technology to monitor the effectiveness of its CBAM. Though CBAMs are considered within some industries to be a trade barrier, Australia looks set to move ahead with a similar system that does not negatively impact trading relationships.

How Avalara can help

UP NEXT: LOOKING AHEAD

Looking ahead

It's probably impossible to cover every sales tax change in one report, so we aimed to spotlight the biggest headlines impacting the tax landscape ... and your business. Leading tax experts take a deeper dive into some of the most pressing issues affecting tax compliance in our **Avalara Tax Changes 2024 webinar**.

FOR MORE RESOURCES:

- Stop by the **Avalara Tax Desk** for breaking tax news
- Read about VAT changes in the **EU and U.K**.
- Check out the **Avalara resource center** for extensive tax compliance content
- Learn how tax changes mentioned in this report may affect your obligations with a free **sales tax risk assessment**

Or give us a call at **877-224-3650**. Avalara is committed to ensuring tax compliance doesn't interfere with the growth or success of your business. Discover how automating tax compliance helps businesses track and comply with ever-changing tax laws around the world.