

Small Business Sales Tax Guide

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Sales tax rules and regulations are ever changing and have become increasingly complex in recent years. Understanding the rules around your products or services, how you deliver them, and to whom you must submit sales tax is a crucial piece in small business compliance. Here is a guide to get started!



Know where you are required to register and collect sales tax, or where your business has sales tax 'nexus'.

Nexus is a relationship that your business has with a state that obligates you to collect sales taxes in that state. Figuring out where you have nexus is the first step you need to take toward sales tax compliance. The foundation of sales tax nexus law is that businesses are only required to collect sales tax for a state if they have a physical presence there. However, in recent years, states have come up with many ways to trigger nexus, and that list is growing as states seek new sources of tax revenue.

Economic nexus

The term economic nexus refers to a business presence in a US state that makes an out-of-state seller liable to collect sales tax there once a set level of transactions or sales activity is met. In the US, sales tax is primarily regulated at the state level, and every state has different laws and rules.

Economic nexus is triggered by reaching a certain amount of sales (e.g., \$100,000) and/or a number of sales transactions (e.g., 200 transactions) in another state.

Within the rules of Economic nexus, many exemptions exist, creating extra layers of complexity. For example, nine states have active exemptions that include gas, food, and food ingredients. And there is an increasing trend of states eliminating sales tax on feminine hygiene products.

(!) **Nexus based on Exempt Sales** Thirty-nine states, and the list is growing, require that Exempt sales of goods and services may count toward your economic nexus threshold.

Physical presence

If your business has a physical presence in a state, you will be required to collect and remit sales taxes there. "Presence" can mean branches, stores, warehouses, drop-shipping facilities or any real estate or property that belongs to your company.

This can also apply if you are using a distribution service that stores your goods in warehouses for you. The presence of your products can trigger nexus in the state in which they are stored, even if you didn't put them there yourself.

Employee location

Nexus can also be created if you employ salespeople in different states or if your employees or contractors conduct any work at a customer's out-of-state location or deliver products in another state. This aspect of nexus has never been more relevant than during the fallout of the COVID-19 pandemic as millions of people were forced to work remotely to avoid close contact with fellow employees.

Shipping and delivery

If you ship goods to customers by a common carrier such as USPS, UPS, or FedEx, you are unlikely to trigger a sales tax obligation through delivery. However, drop shipping — in which you order an item on behalf of a customer from a supplier, who then ships it directly to the customer — can create some nexus complexities. In some states, the use of a drop shipper in the same state as the customer by an out-of-state retailer can create nexus for the seller.

Online affiliate nexus

Several states have expanded the definition of nexus with "click-through" or affiliate nexus laws. In this case, a business in another state sends customers to your business through links on a website, which can create nexus in the originating state. If you are a small business using click-through marketing or affiliate programs to drive sales, you need to know where your referrals are coming from, so you can see if any click-through nexus laws might apply to those transactions.



Know what products or services you are required to collect sales tax on.

Product taxability

It's crucial to have a clear understanding of how your product is categorized for sales tax purposes, because different categories can be taxed at different rates or be exempt from sales tax altogether. And that can be different in each tax jurisdiction.

Information on sales tax rates for your products is available via tax rate tables and state revenue department websites. But beware of plugging in a rate and forgetting it because rates change all the time.

But don't forget about the new Exempt Sales in Economic Nexus states.

Service taxability

As services become a greater part of the economy, more states are applying sales taxes to services as well as product sales. Some common types of services that are taxed include services to tangible personal property, services to real property, business services, personal services, professional services, and amusement/recreation. However, taxation of services is unique to each state.



Know how much sales tax you need to collect.

Once you determine that you need to collect sales tax, you need to figure out the right rate. Particularly if you are an online seller making sales to customers in many different places, there are many variables that can go into calculating the correct sales tax rate.

The sales tax rate that you collect from your customers is a combination of a state rate plus any local rates. In Nebraska, the state rate is 5.5%, plus a city or county rate based on the requirements of the sale. Both amounts are collected as one NE Sales Tax rate. For example, currently Lincoln Ne is 7.25% (State 5.5% + City 1.75%)

To figure out what to charge your customer will require determining accurate sales tax rates based on the requirements of where you deliver your products and services.

Understanding "sourcing" is important to getting sales tax rates right. Origin-sourced sales are taxed where the seller is located, while destination-sourced sales are taxed at the location where the buyer takes possession of the item sold. As a seller, it is important to know whether you are located in an origin-sourced state or a destination-sourced state.

Generally, if you are located in an origin-based state and make sales to customers within that state, you would charge sales tax based on your location, including any local and state taxes.

Meanwhile, in destination-based states, if you are making sales within that state, you will charge state and local taxes based on the location of the customer. However, the rules work differently if you are based in one state and are selling into another state where you have nexus. In this case, sales will generally be destination-based.

Furthermore, these rules get particularly complex with digital products and services, such as videography and photography, where it is important to establish rules that align with how you deliver your projects.

It's common for businesses to use ZIP codes to determine sales tax rates, but this may not always give you the right results. Tax jurisdiction and ZIP code boundaries do not necessarily align, so one ZIP code can include more than one city or taxing jurisdiction and multiple sales tax rates.



Get registered to collect sales tax.

Before you can legally collect sales tax on behalf of a state, you need to register with that state. If you start collecting sales tax without being registered, you could face criminal penalties, so it's an important step.

You will register your business with the state's Department of Revenue and most states offer free online registrations.

If you stop doing business in a state, your nexus may not end immediately. You may still be considered to have nexus for a period that can last through the end of the calendar year or even longer. Make sure you check with the state for the deregistration rules.

If you do not deregister, you will need to continue filing \$0 returns.



Manage sales tax exemption certificates.

Sometimes, transactions that would normally be subject to sales tax are exempted. This could be because your buyer is a reseller rather than an end consumer, or because your customer is exempt from paying sales tax, such as a government entity.

When you make an exempt sale and do not collect sales tax, you need an exemption certificate to prove that no sales tax was due. Exemption certificates should be collected anytime a new tax-exempt customer is buying from you for the first time, or when a certificate you have on file for an existing customer is invalid or is about to expire. Exemption certificate requirements vary from state to state.



File and remit sales tax returns.

Once you are registered with a state, you are required to file regularly scheduled sales tax returns to the state. All states offer electronic filing and payment, and some require it. In most states, you must file sales tax returns even if you didn't collect any tax for the reporting period. This is called zero-tax filing. It's important to file and pay on time to avoid penalties, fines and increasing your chance of being audited. Many states offer incentives to taxpayers who file and pay early or on time by offering discounts on the amount of tax that must be paid.

These can range from 0.5% to 5% and should be booked at income by in your financial records.



Keep accurate records.

It's important to keep good records of your sales tax operations for filing your sales tax returns and in case of an audit. And the pandemic has increased your chances of being audited.

Your records should clearly show where and when your transactions take place and how much tax you collected on those sales — and you should be able to find those records easily when you need them. It is important to show the flow of each transaction. An auditor must be able to follow the trail of each transaction and match up the documents pertaining to each transaction. If an auditor sees that you can effectively show what they ask for, you will save money from penalties you might have otherwise incurred for incomplete or incorrect documentation.