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Sales Tax Corner

Unveiling the Hidden Perils of the Sales Tax Registration Process

By Ilya A. Lipin*

Registering for sales taxes is the first step a company takes to inform a state that it operates within the state's jurisdiction and is accountable for collecting and remitting sales taxes on time. While collecting and reporting a company's data on a registration document might seem deceptively simple, the timing of registration, the content of disclosures, consideration of prior activities and exposure, home rule jurisdictions, and compliance readiness could complicate the process.

This column summarizes common registration inquiries, brings awareness to problematic areas and considerations, and outlines some best practices to ensure successful registration.

Requirement to Register

A company must register for sales tax purposes when its activity in a U.S. state meets the physical or economic nexus standards and any other requirements set by the state. Physical nexus can be established by having employees or independent contractors performing services in the state on behalf of the company, soliciting in-person sales across state lines, participating in tradeshows, having office or equipment in the state, and/or maintaining inventory in warehouses or through fulfillment programs (*e.g.*, Fulfillment by Amazon).

Economic nexus can be established without engaging in any physical activity in a state if the company's sales activity exceeds a threshold (*e.g.*, $100,000 in sales and/or 200 transactions), generally measured in the previous or current year. Determining when economic nexus was established should be based on state-specific measurement methodologies (*e.g.*, all sales, gross receipts, retail sales, or taxable receipts, including or excluding marketplace sales) rather than looking only at whether sales exceeded $100,000. It is incorrect to believe that post-*Wayfair* nexus in a state can be established only *via* economic nexus laws. Nexus can be established through physical activity before economic nexus thresholds are reached and continue after sales or transactions fall below the required thresholds.

Sales tax registration may also be required for remote sellers that drop-ship products—that is, sell products they do not store—if exemption certificates must be issued or are required by specific industry laws.

Registration Types

Sales tax registrations vary by state and in-state activity, and companies, in general, must select one of three registration types based on their in-state activities:

- *Sales tax:* Companies should use this registration type if they have physical nexus with the state.
- *Remote seller's tax, seller's use tax, retailer's use tax, or vendor's use tax:* While the names of this registration for companies without physical presence vary, the concept is the same. Out-of-state companies should use this type of registration if their in-state activities are limited to remote sales (Internet, phone, or mail orders). If a company has a physical nexus and is not a remote seller, it is generally required to use a different type of registration, as noted above.
- *Consumers use tax or compensating use tax:* Companies register for this tax if they have not paid sales tax on taxable purchases in the state and are not registered for sales tax.

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Registration Process

Registration for sales tax requires completion and submission of state-specific forms, most of which are available on state department of revenue websites. As part of the registration process, a company should be prepared to provide the following information:

- Contact information, including name (including doing business as name), mailing address, and telephone number;
- Information about the types of products and services the company sells;
- Date the company began doing business in the state;
- Other registrations with the state;
- Legal entity classification;
- State and date of incorporation;
- Federal employer identification number;
- North American Industry Classification System number;
- Financial institution and banking information for payment of the registration fees and future compliance obligations;
- Accounting period year date;
- Anticipated sales into the state, taxable sales, and return frequency;
- Information about prior acquisitions (whether the company was acquired); and
- Information about the company's officers, directors, shareholders, and other parties responsible for sales tax compliance, including their addresses, dates of birth, Social Security numbers, copies of driver's licenses and passports, dates of taking office, titles, and percentages of ownership.

Social Security numbers and federal employer identification numbers are generally required to complete state sales tax registration forms, so officers/responsible parties or non-U.S. businesses without that information should be prepared for additional scrutiny during the registration process and be able to provide alternative requested information.

Local Registrations

Several states, including Alabama, Alaska, Arizona, Colorado, and Louisiana, are home rule states that allow their cities to administer their own sales taxes. In those states, complexities often arise in determining where, when, and how a company must register for sales taxes and file returns on the local level.

For example, Colorado has 72 home rule municipalities. That means that, in addition to registering for sales tax and filing returns at the state level, companies must consider the second broad level of compliance at the local level, because home rule municipalities can have their own registrations, sales tax rates, and filing obligations.

In 2019, Colorado enacted S.B. 19-006, instructing its Department of Revenue (DOR) and Office of Information Technology to design a centralized sales and use tax system (SUTS) to simplify the multilayered, burdensome compliance process. While home rule municipalities are not required to use SUTS, most have voluntarily opted into the system since its launch in June 2020.

Companies can file sales tax returns *via* the DOR SUTS portal with home rule jurisdictions that opted into the program but must file separate sales tax returns with nonparticipating SUTS localities (*e.g.*, Aspen, Castle Rock, Central City, Delta, Sterling, Telluride, and Woodland Park).[1] However, before filing through SUTS, companies must register outside the system with each home rule jurisdiction and then enter their registration numbers in SUTS.

In 2017, Louisiana, which has 64 parishes, created the Sales and Use Tax Commission for Remote Sellers to provide a centralized registration and compliance platform for remote sellers.[2] Remote sellers with no physical nexus with Louisiana can register through the commission, rather than with the state and each parish, to remit sales tax.[3] If they are already registered with the state and parishes, they can file an application to switch to the commission. Once approved, a remote seller must file a final sales tax return with the state and parishes and attach a copy of the approved application to that return.[4] Until receipt of approval from the commission, remote sellers should continue to remit taxes directly to the state and parishes.[5]

A seller with physical nexus in Louisiana caused by, for instance, holding inventory it owns or having employees in the state, cannot use the commission for registration and compliance and is subject to Louisiana and local collection and remittance requirements.[6]

Alabama has a simplified sellers use tax program that allows remote sellers to register with the state and report and remit a flat 8-percent sellers use tax on all remote sales made into the state.[7] The program relieves remote sellers and their purchasers from any additional state or local sales and use taxes on transactions for which simplified sellers use tax was collected and remitted. Remote sellers that choose not to participate in the program and companies with physical nexus in Alabama must comply with traditional sales and use tax collection and remittance regimes at the state and local levels.

Responsible Parties

Sales tax represents funds held in trust for the state. Individuals entrusted with the control of those funds can be held personally liable for compliance delinquencies or failure to timely remit collected sales tax to the state. States look to registrations as the initial means of identifying responsible parties that may be held personally accountable for noncompliance. It is important that individuals listed on the registration understand their additional duties and potential liabilities.

As an example, under Kentucky law, individuals holding corporate offices such as president, vice president, secretary, treasurer, or any equivalent position can be held personally liable, jointly and severally, for the failure to pay sales tax when due.[8] The same personal liability also applies to managers of a limited liability company, partners of a limited liability partnership, general partners of a limited liability limited partnership, or any other person holding a similar office.[9] In Ohio, employees with control or supervision over, or charged with the responsibility for, filing returns and making payments are subject to personal liability for failure to file or pay sales tax.[10]

If collected sales tax was not paid under a responsible party's watch, that party could be subject to penalties of up to 100 percent of the tax owed.[11] Failure to remit sales taxes can also result in criminal penalties, including fines and even incarceration.[12]

Social Security numbers and federal employer identification numbers are generally required to complete state sales tax registration forms, so officers/responsible parties or non-U.S. businesses without that information should be prepared for additional scrutiny during the registration process and be able to provide alternative requested information.

It is imperative to keep registration updated to reflect the responsible party when returns are filed. When there is a change of responsible parties and individuals who file sales tax returns, registrations must be timely updated. If not, former responsible parties could be included in actions to collect unpaid sales tax and will have to prove their lack of involvement in tax compliance, lack of authority to make decisions and payments on behalf of the company, lack of knowledge about delinquencies, lack of control or ownership, and other state-defined factors.[13]

Addressing Prior Sales Tax Exposure Before Registration

If a company had nexus and registration requirements with the state but did not register in a timely manner, it should:

- Assess its potential sales tax exposure, including interest and penalties that together can add up to 35 percent; and
- Discuss options with a tax advisor that may include participating in voluntary disclosure agreement (VDA) programs, tax amnesties, or compromise agreements; filing past returns; and seeking penalty abatement.

VDAs are designed to promote compliance among taxpayers who discover past filing obligations and liabilities that have not been discharged. They limit exposure for retroactive tax liabilities to a specific set of tax years (typically three to four years) and reduce or abate interest and penalties. In most states, a company is disqualified from the sales tax VDA program if it has already registered for the tax involved or if the tax has already been collected.

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A company with known prior sales tax exposure that chooses prospective registration, rather than registration from the date it first established physical or economic nexus with the state, and does not remediate past liabilities further complicates its compliance obligations. Using data and technology, state and local governments are becoming better at identifying compliance gaps and determining when a company should have registered for sales tax. For instance, the authorities can review and match a company's payroll records against sales tax registration to determine whether a remote employee was working in or visiting the state. They can also obtain data through third-party audits and investigations to help establish a timeframe of a company's in-state activities, including inventory location, supplier shipping information, customer purchase data, and trade show attendance. Marketplace facilitator compliance records can track the volume of sales into the state from a particular remote seller and help determine whether registration was necessary.

Compliance Readiness

Compliance readiness is an important factor in the sales tax registration process. A month after registration, sales tax returns will become due for the prior month of activity. For instance, if a company registers for sales tax as of October 1, 2023, its first return will be due on November 20, 2023. A person with sales tax expertise who will be responsible for timely filing returns must be identified during the registration process.

A company automating its sales tax through the implementation of compliance software tools should make sure that the engine is operational at the time of registration. If a company already has a functioning engine, it should confirm that the new state is included in its future filings. If the engine is not working, the returns will have to be prepared and submitted manually.

Recommended Best Practices

When and how to register for sales tax might not be as straightforward as completing a form. The following nonexclusive list of potential action steps should help companies navigate the complexities surrounding sales tax registration:

- Identify the exact date nexus and registration requirements that arose in a particular jurisdiction, considering all of the company's economic and physical operations there. For economic nexus, determine which sales count toward the threshold (all gross receipts, only taxable sales, nonexempt sales, *etc.*) and verify if the proper measurement period was used (past or current year, current year, last 12 months).
- In home rule states, consider whether a separate local registration is required and how and when it should be submitted.
- Review the registration process and determine which forms must be completed. Most states allow sales tax

registration to be conducted electronically. Hard copy registration sent by mail or fax generally takes more time to process.

- Some states do not require remote sellers to register for sales tax if all their sales in the state are exclusively through marketplace platforms. However, if a company begins to have sales outside the marketplace platform and establishes nexus with the state, registration requirements should be reviewed.
- Be sure the information submitted on the registration form is accurate and that the correct tax is selected (sales tax, seller's use tax, vendor's use tax, gross receipts tax, *etc.*). The state might compare the submitted registration against information it already has about the company: Gaps or inaccuracies in information or improperly selected taxes could lead to notices and audits.
- To account for security checks and authentication notifications, perhaps set up a generic email address (*e.g.*, *tax@company.com*) so that various team members can access and receive notifications.
- If a company had prior operations and did not timely register for and comply with sales tax, it should evaluate its product and service taxability in that jurisdiction and then quantify its sales tax exposure back to the date the registration requirement was triggered. As part of quantification, the company should determine if its sales may be exempt (*e.g.*, sales for resale or for use in manufacturing) or if its customers have self-accrued and remitted use tax.
- Exposure estimates are used to determine appropriate efforts to mitigate and disclose taxes. Entering into a VDA or amnesty program (if available) with tax authorities can significantly reduce the tax, penalties, and interest ultimately paid to resolve historical tax liabilities. VDAs and amnesty programs can also streamline tax registration and return filings, as well as payment of historical tax liabilities. If the period of noncompliance is relatively short, remediation may also be achieved by filing late returns and addressing interest and penalties.
- Consider the potential implication of sales tax registration on a jurisdiction's other state and local taxes based on income/franchise, net worth, and gross receipts. Does the company also have nexus for other taxes and potential prior exposure?
- Be prepared to file returns a month following registration with the state. To be successful from the start, an experienced sales tax professional responsible for the compliance function must be identified, and if an automation engine is being used, it must be properly configured before returns are filed.
- Keep proper information on file with the state. For instance, an update should be made when the responsible party listed on the registration leaves the company. If an update is not made, the responsible party may continue to have personal responsibility and liability if sales tax is not paid.

ENDNOTES

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1 Colorado Department of Revenue, "SUTS Participating Jurisdictions" (undated).

2 Louisiana Sales and Use Tax Commission for Remote Sellers, "Frequently Asked Questions Louisiana Sales and Use Tax on Remote Sales" (undated).

3 *Id.*

4 *Id.*

5 *Id.*

6 *Id.*

7 Alabama Department of Revenue, "Related FAQs in Simplified Sellers Tax" (undated).

8 Ky. Rev. Stat. Ann. Section 139.185(1).

9 Ky. Rev. Stat. Ann. Section 139.185(2).

10 Ohio Rev. Code Ann. Section 5739.33.

11 Ala. Code Section 40-29-72.

12 Brian Kirkell, David Brunori, & Mo Bell-Jacobs, "Steps to Avoid Personal Liability for Sales and Use Taxes," *Bloomberg Tax* (May 19, 2023).

13 *See, e.g.*, Pennsylvania Board of Finance and Revenue Decision No. 1522488 (Sep. 26, 2016); *Sousa v. Harris*, No. 2020-742 (Ohio BTA 2023).