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United States Sales and Use Tax Guide

When it comes to United States sales and use tax, foreign investors are surprised by the differences between U.S. sales and use tax and Value Added Tax (VAT) in other countries. U.S. sales and use tax is similar to Valued Added Tax (VAT) as both are indirect taxes. However, U.S. sales and use tax are imposed on the sub-national level because U.S. does not have a national system for sales and use tax. Each state has its specific authority to impose the sales and use tax with subjection of U.S. constitutional restrictions. Some local jurisdictions (including cities and counties) may also impose sales and use tax for economic and social considerations.

This guide provides an overview of the key concepts of U.S. sales and use tax, including the definition as well as Nexus standards, registration, criteria for sales and use tax registration, calculating, collecting, and filing of sales and use tax, and penalties.

1. Definition of U.S. Sales and Use Tax

U.S. sales and use tax are imposed on the sale of tangible personal property and certain services in 45 States and the District of Columbia in the U.S.

Sales tax is a gross-basis tax imposed on the retail of most tangible personal property and certain services. Sales tax generally applies on the sale to the end user or ultimate consumer, usually known as RETAIL, it is added to the sales price, and then the total amount should be collected from the purchaser.

Sales of tangible personal property are generally taxable unless specifically exempted. Sales for resale or wholesale are usually exempted.

Services are generally nontaxable unless specifically included. Taxable services may include public utility services, admissions to public events, data processing etc.

Sale of intangible property, such as sale of stocks, bonds and copyright, are generally not subject to the tax.

Use tax is imposed on the storage, use, or consumption of a taxable item or service on which no sales tax has been paid. Use tax is a complementary or compensating tax to the sales tax and does not apply if the sales tax was charged. Use tax applies to purchases made outside the taxing jurisdiction but used within the state. Use tax also applies to items purchased exempt from tax which are subsequently used in a taxable manner.

2. "Nexus" of Sales and Use Tax

Unlike U.S. income tax, sales and use tax are not covered by international tax treaties. Therefore, any type of company with business activities in the U.S. should consider whether it has sales and use tax responsibilities in one or more states. Currently, a business is required to comply with sales and use tax laws in those states where they have the substantial connection, also called "Nexus". Sales and use tax "Nexus" is the connection between a seller and a state that requires the seller to register, collect, and remit sales tax on sales made in the state.

Traditionally, "Nexus" used to be based on physical presence, such as having office, employees, or other substantial presence in a state.

However, "Economic Nexus" is established since 2018 case South Dakota vs Wayfair. "Economic Nexus" is created when a remote seller has more than $100,000 in sales or at least 200 transactions in the taxing state in the current or previous calendar year. Many states have updated legislation in response to the "Eeconomic Nexus" requirements.

3. Sales and Use Tax Permit Registration Procedures

A foreign/domestic invested U.S. company that sells tangible personal property or provide certain taxable service, may have "Nexus" at the states where the business activities happen. In this case, the U.S. company is required to register with the state tax agency to obtain the sales and use tax permit/certificate, which is used to file sales and use tax returns and pay the sales and use tax accordingly.

Sales and use tax can be applied online, by fax, or by mail, and the processing time is various from immediately to 3 weeks, depending on specific state requirement.

To apply the sales and use tax permit, the company usually needs to provide the following information:

- Registration information of the company
- Federal Employer Identification Number (EIN)
- Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN) of the company's authorized person

Upon approval of sales and use tax registration, you will receive the sales and use tax permit and registration letter. This permit and letter will contain your sales and use tax account number, the effective date when your business become sales and use tax registered business, your filing frequency and filing due dates, as well as any other special instructions. You must file your sales and use tax returns electronically.

4. Criteria for Sales and Use Tax Registration

Sales and use tax are a self-assessed tax and businesses are required to assess the need to register the sales and use tax permit. Sales and use tax registration fall into two categories: compulsory registration, voluntary registration.

(1) Compulsory registration

Typically, every person or entity that is engaged in the business of selling tangible personal property at retail, or furnishing any taxable service, must register with the state to obtain the **sales and use tax permit/certificate** before making sales or providing services. Engaging in business in the state can be determined by "Nexus", especially the "Economic Nexus" mentioned before, such as annual volume of sales or number of transactions. The sales and use tax permit/certificate gives your business the authority and responsibility to collect sales and use tax from customers and remit the tax to government.

Besides obtaining the sales and use tax permit/certificate, when your business does resale (as a reseller) in certain state, a **resale certificate** is necessary to make sure you can buy items without paying sales tax on those items. Meanwhile, the company selling items to you will not charge sales tax. Some states issue official resale certificates, some states offer a template for you to fill out with detailed business information.

(2) Voluntary registration

An overseas or out-of-state company without substantial Nexus in a state may voluntarily register for collection of sales or use tax. A taxpayer voluntarily registering for sales or use tax is subject to the same duties and obligations as a taxpayer who is required to register and will be required to file returns and comply with the laws of that state.

(3) De-registration

You can cancel your registration when your business is closed or when your business is sold to another person or when you no longer have Nexus in the taxing state. In most cases, filing a “final” sales tax return is all that is required to accomplish this act. Some states have additional forms that must be completed to cancel the sales and use tax registration.

5. Calculation and Collection of Sales and Use Tax

Generally, sales price or purchase price is the tax base for sales tax and use tax. However, states are not uniform in defining what is to be included in the price, such as service charges, so it is possible to owe different amounts of tax on the same transaction even when the states have the same tax rate.

State imposes different sales and use tax rates for different categories, but the rates for items within the same categories are the same. In addition, local sales and use taxes are imposed by cities, towns, special taxing districts. Any company subject to sales and use tax needs to consider both the state and local sales and use tax rates for location.

There are five states do not have the state-wide sales tax, including New Hampshire, Oregon, Montana, Alaska, and Delaware. However, Alaska does have local sales taxes imposed by local jurisdictions.

You must keep everything in record when it comes to sales and use tax documentation, such as the following items:

- Sales receipts (electronic or paper)
- Exemption certificates
- Resale certificates from your customers for each transaction
- Sales and use tax returns
- Purchase invoices/payable (all invoices)

6. Filing of Sales and Use Tax Returns

Most states require that, once registered for sales and use tax, the sales and use tax return must be filed for every required filing period, regardless of whether there are sales or not. The filing frequency can be affected by differences in business type, sales volume and the amount of tax due. For example, usually large retailers must file monthly.

Annual filing is common for wholesalers who usually have little or no sales tax to remit.

When you file a sales and use tax return, it must show the total sales, taxable sales, the sales and use tax collected and sales and use tax claimed for that accounting period and other information.

The remit of sales and use tax is usually due upon filing the tax return. Failure to remit the tax with or before the return is due will expose the taxpayer to late payment penalties, and interest.

7. Penalties

(1) Late Registration

As stated above, when your company create the "Economic Nexus" at certain state, your business should apply for sales and use tax permit, then collect and remit sales and use tax to the tax authority on the goods and services it sells. Failure to register for sales and use tax may create serious consequences, such as pay sales and use tax for past sales starting from the effective date of registration and pay penalty.

(2) Late Filing and Payment of sales and use tax

When a state imposes a penalty for not filing and paying on time, the taxpayer may request a waiver of the penalty for the first time (not guaranteed). Generally, a written appeal should be submitted to the state, explaining the circumstances that led to the late filing. If the reason for filing late indicates reasonable cause and is something out of the taxpayer's control, the state will likely consider waiving the penalties.

When there is intent to evade or not report the correct state tax due, a state can impose a penalty equivalent up to 100% of the additional tax due.

If you wish to obtain more information or assistance, please visit our official website at www.kaizencpa.com or contact us through the following and talk to our professionals:

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