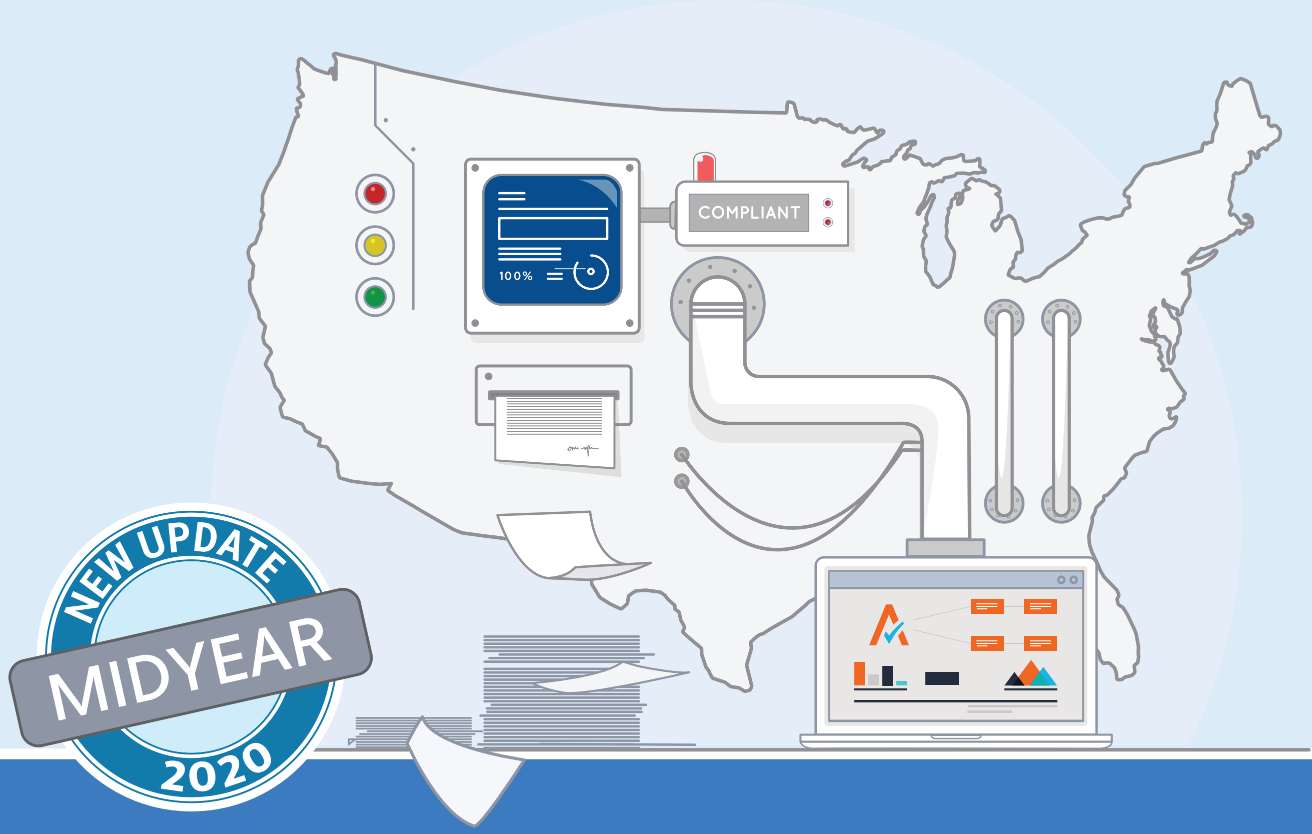


2020 sales tax changes

midyear update

Avalara
Tax compliance done right

Whitepaper

Sales tax is notoriously mercurial, but when we launched **2020 sales tax changes** at the end of 2019, we thought we had a pretty good idea of what 2020 would bring. ***Ha.***

Many of our projections are coming to pass, as this report will explain. What no one anticipated was the coronavirus (COVID-19) pandemic or its impact on buying habits, businesses, and tax policies.

COVID-19 sparked new tax relief programs around the globe – some now expired; some with a longer tail. It disrupted supply chains, triggering runs on disinfectant and toilet paper while shuttering "nonessential" brick-and-mortar businesses. Yet the pandemic also accelerated trends, such as the shift toward ecommerce and digital goods and services. Zoom became a household name in a matter of weeks.

Stay-at-home policies and travel restrictions have altered how and where we spend our money, while decreasing tax collections at a time when governments are spending more. For now, states must rely on existing revenue streams, so this report will highlight economic nexus, marketplace facilitator laws, product taxability rules, and other familiar themes. Since changes in consumer habits and economic downturns often lead to new tax policies, we'll also examine COVID-19's impact on tax policy.

A lot has changed in the past six months, but our **2020 sales tax changes midyear update** is what it always is: a recap of the sales tax changes from the first part of the year and predictions of more to come.

I. COVID-19

When stay-at-home orders forced brick-and-mortar businesses to close or drastically limit their offerings, some online sales took off. Comparing data from the last two weeks of March 2020 with the last two weeks of January and February, Avalara was able to track shifts in consumer spending. As could be predicted, sales of formal wear plunged, as did sales of dental services, car products, and sports equipment. On the other hand, sales of cleaning products increased by 85%, home office sales increased by 163%, and home fitness sales jumped by 210%.

Amazon was so overwhelmed by orders for essential products that it temporarily stopped taking new inventory of nonessential goods and prioritized sales of essentials. While perhaps necessary, this reveals just how much control marketplace facilitators have over what transpires through the platform. It could also compel marketplace sellers to develop other channels, such as their own ecommerce stores.

The events of recent months could do the same for brick-and-mortar businesses. Those with ecommerce stores already up and running were able to transition to online selling when in-store sales were prohibited. They could ship products or offer a buy-online-pick-up-in-store option. Even grocery stores got into the game, following the example of Whole Foods delivering online food orders, or packing them up for pickup.

Simply put, brick-and-mortar retailers that lacked an online store when the pandemic hit had a harder time reaching customers. Thus, COVID-19 will likely accelerate the shift toward ecommerce, or at least online purchase options.

> Retailers with established ecommerce stores were able to focus on online selling when in-store sales were prohibited because of COVID-19.

New products, new customers, new tax obligations

Some manufacturers whose sales were depressed quickly pivoted to make products with higher demand. Thus, bathing suit and fashion manufacturers began producing face masks and gowns. Breweries and distilleries learned how to make hand sanitizer.

While brilliant, selling new products can create new or different tax obligations. A sudden increase in sales of highly sought-after items could trigger economic nexus in new states. Selling products to exempt organizations could complicate exemption certificate management. And so on.

COVID-19 could also encourage international growth because new markets must be targeted when demand drops in familiar channels. That can be exciting. It can also lead to unexpected challenges. Cross-border sales are generally subject to customs duty and import taxes. Even different shipping methods can have consequences.

Temporary sales tax relief

To help businesses whose sales plummeted because of the pandemic, some state and local governments were quick to develop tax relief programs. Sales tax relief varies by state and locality and includes:

- **Waiving penalties or interest on late payments, automatically or upon request**
  - Alabama waived late payment penalties for small retailers with monthly retail sales averaging $64,500 or less and taxpayers in the food and hospitality industries; it did not waive interest
  - Mississippi waived penalties and interest on any unpaid tax balance until the end of the period covered by the presidentially declared national emergency
- **Extended filing and payment due dates for sales tax**
  - California gave taxpayers filing a return for less than $1 million in sales and use tax until July 31, 2020, to file and pay sales and use tax for the first quarter
  - Florida taxpayers adversely affected by COVID-19 had extra time to file and remit taxes collected in February and March
  - Vail, Colorado, extended the due date to August 20, 2020, for sales tax collected February–June
- **Temporary sales tax exemptions**
  - Puerto Rico temporarily exempted sales of grocery foods, disinfectants, masks, and other essentials

> Sales tax liability never disappears. It follows the business – and ultimately the business owner – until paid.

Payment extensions may relieve pressure in the moment, but it's important to remember sales tax liability never disappears: It follows the business and ultimately the business owner until paid. Unfortunately, companies that use deferred sales tax collections to cover other costs (e.g., payroll or rent) could end up deeper in the hole. To help prevent that, California built a payment plan into its sales tax relief program: Penalty-free and interest-free deferred liabilities are due in 12 equal monthly installments.

Tax relief isn't just about extensions, exemptions, and penalty waivers. Several Louisiana lawmakers proposed temporarily suspending collection of sales tax or other taxes, and some Washington state lawmakers are calling for sales tax holidays. These may be long shots, but they show how state leaders are trying to find creative solutions to an unexpected situation.

Other tax relief

Many states are providing relief for other taxes as well, including alcohol beverage taxes, communications taxes, and lodgings taxes. When the deadline to pay then file federal income tax was pushed back to July 15, 2020, states extended their income tax due dates as well. There are also a host of federal, state, and local aid programs, some easier to negotiate than others.

Global tax relief

Since COVID-19 is a global pandemic, tax relief efforts aren't limited to the United States. Canada deferred payments of national Harmonized Sales Tax (HST) and customs duties, and many provinces implemented provincial sales tax relief. Meanwhile, Mexico is speeding up Value-Added Tax (VAT) credit repayments.

Bolivia, Colombia, Greece, Israel, Slovenia, and Thailand are among the countries that delayed VAT filings due to the coronavirus. Malaysia temporarily cut the tax on accommodation and hotel services, along with sales of tobacco and alcohol in hotels. Pakistan is looking to reduce sales taxes on basic foodstuffs. Ukraine decreased the VAT rate on domestic electricity and utilities, paused the tourism tax until the end of the year, and exempted certain medicines and hospital supplies from import VAT. The list goes on.

For businesses struggling to stay solvent, keeping track of extended due dates and rate reductions is an added stressor. To help, we compiled U.S. and global tax-related news in this COVID-19 tax relief roundup, which we update regularly.

But there's more to tax news than COVID-19. In fact, June marks the two-year anniversary of an historic decision on sales tax.

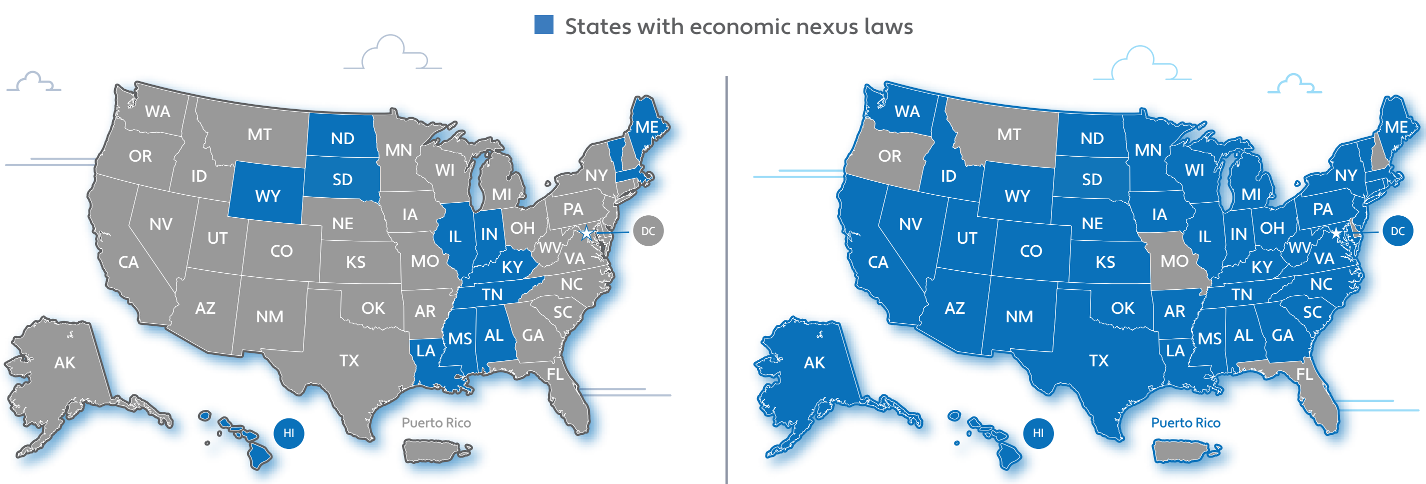
II. Happy birthday, South Dakota v. Wayfair

Two years ago, on June 21, 2018, the Supreme Court of the United States ruled in favor of the state in South Dakota v. Wayfair, Inc. It was a pivotal decision for sales tax, states, and businesses.

Here's a recap: The Wayfair decision overruled a long-standing physical presence rule that, according to the majority, treated "economically identical actors differently for arbitrary reasons." For example, a business with just a few items of inventory in a small warehouse in a state was obligated to collect and remit that state's sales tax on all its sales, while an internet seller with a "pervasive" presence couldn't be required to collect tax on similar sales.

> South Dakota v. Wayfair, Inc. allows states to enforce economic nexus, meaning they can require out-of-state sellers with a certain amount of sales in the state to collect and remit sales tax.

Because of the Wayfair decision, states can now enforce economic nexus, basing a sales tax collection obligation solely on a remote seller's economic activity in a state – sales or transaction volume. Within days of the decision, three states started enforcing economic nexus laws modeled on the South Dakota law allowed to stand by the court.



June 21, 2018 (day of South Dakota v. Wayfair, Inc. ruling)

June 21, 2020

[One state after another adopted economic nexus]() over the past two years, and as of June 2020, 42 states and Washington, D.C., enforce it. [Louisiana](), one of the first states to enact economic nexus, will at last enforce it starting July 1, 2020.

There's even [economic nexus in Alaska](). Although there's no statewide sales tax in The Last Frontier, roughly 100 local governments levy local sales tax. A growing number of these now require remote retailers with economic nexus in Alaska (based on statewide sales) to collect and remit local sales tax.

Despite all this state activity, many retailers remain unaware of the Wayfair ruling and its possible impact on their business. As a result, they're at risk of being out of compliance.

The stragglers: Florida and Missouri

High hurdles stand between Florida and Missouri and economic nexus. Many lawmakers in Florida are opposed to adopting anything that could be construed as a new tax. Missouri has a complicated sales tax system that would make compliance extremely challenging for remote vendors.

Nonetheless, there's strong support for economic nexus legislation in both states, among lawmakers and especially among brick-and-mortar retailers, who see it as necessary for leveling the playing field.

The COVID-19 pandemic could be what these holdouts need to get economic nexus across the finish line: Both states are now dealing with unexpected deficits because of the crisis; and Florida is heavily dependent on sales tax revenue. Requiring out-of-state vendors to collect and remit sales tax would bring them both sorely needed revenue.

As Florida and Missouri grapple with whether to adopt economic nexus, other states are refining existing economic nexus laws.

The evolution of economic nexus

Several states have already altered their economic nexus laws. In 2019, California, Colorado, Iowa, North Dakota, and Washington eliminated their transactions threshold, so that economic nexus in those states is now based on a remote seller's sales volume alone. Several states changed the sales threshold: California and New York increased it to $500,000; Georgia lowered it to $100,000.

> Not all economic nexus laws are fully baked. Some states are still refining them, eliminating transaction thresholds, altering sales thresholds, and simplifying sourcing rules.

That trend continues in 2020: Wisconsin is looking to eliminate its economic nexus transaction threshold, though the billed failed to pass the first time through. Additionally, the Multistate Tax Commission recommends states base the thresholds on retail sales only, which would eliminate registration requirements for remote wholesalers. State economic nexus thresholds vary considerably, which is difficult for businesses selling into multiple states.

The need to simplify sourcing rules has also been raised. While most states base sales tax on the destination of the sale (the location where the buyer takes possession), some use origin sourcing or a combination of destination sourcing and origin sourcing. Texas, which has extremely complicated sourcing rules, is working to simplify them.

Finally, states could make the sales tax registration process less stressful for remote sellers. Approximately 10 states require remote retailers to register with the tax department as soon as an economic nexus threshold is crossed – as in, before the next invoice is issued. The American Institute of Certified Public Accountants recommends giving remote retailers a 90-day grace period.

The long trail of nexus

California recently clarified its trailing nexus policy, i.e., how long remote retailers with economic nexus in the state must continue to collect and remit sales tax after their sales drop below the economic nexus threshold ($500,000). We now know it's through the end of any calendar year when sales exceeded the threshold, and through the following calendar year.

Some states have clearly defined trailing nexus policies, but many don't. Economic nexus thresholds may eventually compel states to address this issue.

Economic nexus beyond sales tax

Alabama, California, Colorado, Connecticut, and New York are among the states that held out-of-state businesses with a certain level of sales in the state liable for state income taxes even prior to Wayfair, as Ohio did for its Commercial Activity Tax (CAT) and Washington with its Business and Occupation (B&O) tax.

Since the decision, an economic nexus standard has been applied to income tax in Hawaii, franchise tax in Texas, and several taxes in Portland, Oregon, and San Francisco. Other states and localities could follow suit, especially those with budgets gutted by COVID-19.

Indeed, the pandemic may have long-term nexus implications for businesses with employees residing across state or city lines. Some states, including Massachusetts and Pennsylvania, said they'll temporarily waive enforcement of certain nexus laws for employees temporarily working from home because of COVID-19. They also made clear such leniency wouldn't be extended once stay-at-home orders are lifted.

On the other hand, New York Governor Andrew Cuomo announced that residents of other states temporarily working in New York due to the crisis *will* be liable for New York state income tax.

No matter what happens with this pandemic – whether there are multiple waves as some experts anticipate – more people are likely to spend more time working from home in the months and years ahead. In a recent Gartner survey, 74% of respondents said they intend to keep a portion of their workforce remote after the threat of COVID-19 passes. Sooner or later, this will likely have tax implications.

III. State tax departments find creative ways to get more tax revenue

COVID-19 has cratered budgets. Even states with healthy reserves are likely to need additional revenue in the months to come.

Some states with no sales tax are talking about creating a sales tax. Other states may be reluctant to impose new taxes at this time, but they're unlikely to hold back on enforcing existing laws. Going after noncompliant vendors is a tried-and-true method of increasing collections. There are many ways to do this.

- **Shop around.** Auditors can shop online to see whether remote retailers collect the tax due under economic nexus laws. States may have eased into enforcement of economic nexus, but now that two years have passed since the Wayfair decision, they're taking their gloves off. They know where to find the revenue they need.
- **Connect the dots.** Use marketplace facilitator and non-collecting seller use tax reporting laws to identify marketplace sellers. Though marketplaces may be taking care of sales tax for them today, marketplace sellers could be liable for periods prior to the effective dates of these laws. California is among the states pursuing marketplace sellers for uncollected back taxes – liabilities created through inventory in the state.
- **Mine data.** Tax authorities around the globe now use data analysis to identify businesses with a high probability of noncompliance.

And of course, states can simply hire more auditors.

States with no statewide sales tax embrace sales tax

It's hard to imagine the Live Free or Die State embracing sales tax. Yet earlier this year, a couple of New Hampshire lawmakers introduced a bill that would tax sales of certain electronic products.

Sales taxes are periodically proposed in Alaska, Montana, and Oregon. Sometimes the idea even takes hold. While none of these states has ever adopted a general sales tax, the Beaver State now taxes sales of certain bicycles. And of course, Alaska has a robust local sales tax system.

A New Hampshire sales tax is unlikely to gain traction this year, despite new budgetary concerns brought on by COVID-19. Still, the fact that it was introduced in such a staunchly anti-sales tax state is worth noting.

Real-time remittance

Massachusetts Governor Charlie Baker is a big proponent of daily sales tax remittance. Under his 2021 budget proposal, some retailers would initially need to remit sales tax by the end of the month it's collected, rather than by the 20th of the following month. Eventually, they'd have to remit it daily.

Real-time collection has been considered in several other states, including Connecticut, Nebraska, and New York. All abandoned the idea for now, but these states and others will likely revisit it in the future.

It's an idea that's also under development in other countries. Brazil led the charge: Tax authorities there are alerted, in real time, whenever an electronic invoice is remitted. Greece will soon require retail cash transactions to be recorded by certified VAT electronic cash registers, which report each transaction to the tax authorities in real time. Several other European countries have also introduced electronic cash registers

IV. States turn attention to digital world

States seem to be playing an endless game of chase these days, thanks to rapidly evolving technology and consumer habits. Just when states appear to catch up, ***boom***, they get left in the dust.

For example, it took states decades to win the right to tax remote sales – long after the internet brought stores home in a way they never had before, not even with catalogs. After making huge gains with South Dakota v. Wayfair, Inc. and subsequent state economic nexus laws, states had to scramble again to close the loop allowing third-party marketplace sales to go untaxed. States that haven't adopted economic nexus or marketplace facilitator laws are missing out on needed revenue, especially now that COVID-19 has more people shopping online than ever before.

More catch-up is needed: Despite today's service economy, sales tax laws continue to center on tangible personal property and exempt most sales of services. Some states are working to change that, but it's an uphill battle. Still, it may need to be done.

> More and more activities are moving online, including conventions, trade shows, and school. Virtual haircuts are no longer the stuff of science fiction. Even happy hours and wine tasting are happening virtually these days.

Consumption of digital goods and services was on the rise before we were asked to stay home to help slow the spread of the coronavirus; stay-at-home orders merely amplified it. In recent months, virtual haircuts left science fiction for the real world. In-person conventions and trade shows moved online, as did school and work. Even happy hours and wine tasting are happening virtually these days.

In-person events raise tax revenue in a multitude of ways: Travelers pay taxes on transportation and lodgings taxes on their hotels and short-term rentals. They eat restaurant meals that are generally taxed at a higher rate than groceries. They pay sales tax when purchasing essentials and souvenirs. The more we communicate, learn, play, shop, and work online, the more compelling it becomes for states to tax these innovative solutions.

Communications taxes may also apply to these transactions. Steve Lacoff, general manager of Avalara for Communications, notes, "The line that separates the requirements for sales and use tax from more complex communications tax rates and regulations is a critical one. It can also seem incredibly blurry, especially for those who aren't well versed in untangling the nuances of these scenarios." Some sales are subject to sales tax only, some only to communications tax, and some to both.

Video conferencing and similar services could be particularly vulnerable to taxation in Ohio, Texas, and other states that held onto their internet taxes for as long as possible. As of July 1, 2020, they'll be forced to eliminate taxes on internet access fees under the Internet Tax Freedom Act. That will have an enormous impact on their budgets.

In short, a Wayfair for communications taxes is almost certainly on the horizon. Businesses should start preparing for a new reality.

V. Amazon, eBay, and other marketplaces get their own sales tax rules

Like economic nexus, marketplace facilitator laws are now the norm. They're also evolving.

Four states still give marketplaces a break … for now

New sales tax collection requirements for marketplace facilitators took effect in parts of Alaska as early as February 3, 2020, and are gradually being adopted by other boroughs and cities in the state. A marketplace facilitator law took effect in Georgia on April 1, 2020, the same day marketplace facilitator legislation in Tennessee was signed into law. Puerto Rico also enacted a marketplace facilitator law. As of this writing, its effective date is up for grabs: It could be October 1, 2020, or it could be retroactive to January 1, 2020.

A marketplace bill approved on the last day of the Louisiana session was signed into law on June 11, 2020. It takes effect July 1, 2020.

As we move into the second half of 2020, only four states with a general sales tax don't have a marketplace facilitator law: Florida, Kansas, Mississippi, and Missouri. All considered marketplace facilitator legislation during their 2020 legislative sessions, most of which were interrupted by COVID-19. Expect marketplace facilitator legislation to resurface in these states when lawmakers next convene.

Fine dining: Refining marketplace laws

As with economic nexus, states are starting to hone their marketplace facilitator laws. They're taking into consideration the effect of these laws on franchises and marketplaces that facilitate sales for large sellers. For example, under Georgia's new law, facilitators are not responsible for the tax due on sales by certain sellers with $500 million or more in annual gross sales in the Peach State during the prior calendar year.

Some states are also working to determine how marketplace laws affect food-delivery network companies. Marketplace laws were created with Amazon and eBay in mind. Should they also apply to DoorDash and Grubhub?

California's marketplace facilitator law doesn't generally apply to delivery network companies. However, it allows them to elect to be deemed a marketplace facilitator liable for the tax. Nebraska's marketplace law does apply to marketplace providers, thus food-delivery providers are generally responsible for collecting and remitting the tax due. That's not the case in Tennessee, where a new marketplace law specifically excludes delivery network companies from the definition of a marketplace facilitator.

It's not just about sales tax

Until recently, marketplace facilitator laws focused only on sales tax: They make marketplace facilitators responsible for collecting and remitting tax on third-party sales.

States may soon ask more from marketplaces. Louisiana would require marketplaces to work to prevent sales of counterfeit products, which have exploded. This issue is also being discussed in Congress. A measure introduced in early March (Shop Safe Act of 2020) would make marketplace platforms "contributorily liable" for counterfeit sales by third-party sellers.

VI. Tax on, tax off: Product taxability remains in flux

Never content to simply tax the taxable and exempt the exempt, states continue to tweak their product taxability laws. For example:

Digital products

The Maryland General Assembly passed a bill that would tax the retail sale and use of digital codes and digital products starting July 1, 2020, and another that would tax annual gross revenues derived from certain digital advertising services. Governor Larry Hogan vetoed them both, explaining they would raise taxes on Marylanders "at a time when many are already out of work and financially struggling." It's unclear whether he would have signed the measures had there been no coronavirus pandemic.

A measure still alive in Nebraska seeks to broaden sales tax to numerous services as well as digital products. It would also reduce the state sales tax rate from 5% to 4%. The bill may be discussed when the Legislature reconvenes in July, after breaking early because of COVID-19.

Groceries, guns, and gun safes

Certain gun safes will be exempt from Virginia sales tax starting July 1, 2020. Meanwhile, the South Dakota Legislature introduced a measure to exempt firearms from retail sales and use tax, while Iowa lawmakers proposed a new sales tax holiday for firearms and firearm ammunition. If approved, it would be held "during the period surrounding Independence Day."

Sales taxes on groceries could be a topic of discussion in the coming months. Prior to the COVID-19 crisis, Alabama was looking to eliminate the sales tax on groceries, which would put it more in line with most other states' policies. Yet since grocery sales – and especially online grocery sales – surged because of the pandemic, states in need of more tax revenue may consider broadening sales tax to groceries. It would likely be a tough sell.

Menstrual products

Calls to exempt feminine hygiene products are sounding in numerous states, including Missouri and Tennessee. Missouri is looking to cap the sales tax imposed on feminine hygiene products, subjecting them to the lower rate imposed on food (currently 1.225%). And a measure introduced in Tennessee would add menstrual products to the list of items qualifying for the state's annual sales tax holiday; headlines screamed about one lawmaker's concerns that women would take advantage of the tax break to stockpile feminine hygiene supplies – but this was before the COVID-19 run on toilet paper and hand sanitizer.

The sales tax rate on essential personal hygiene products was reduced to 2.5% in Virginia on January 1, 2020. In Washington state, these products are exempt from sales tax starting July 1, 2020.

Looking ahead

The coming months, like those recently passed, will call for adaptability and ingenuity. According to the United Nations, "nearly 90 per cent of the world economy has been under some form of lockdown, disrupting supply chains, depressing consumer demand and putting millions out of work." Moving forward, businesses will need to do more with fewer resources.

The U.N. also expects the pandemic to accelerate digitalization and automation and lead to a "rapid surge in economic activities online." Automating essential tasks like registration, sales tax collection, and filing and remittance is a good first step.

This report is a snapshot of overarching trends. We also track news as it happens. Look to our comprehensive resources for the latest on transaction tax in the U.S. and abroad:

- **COVID-19 hub:** The go-to page for COVID-19-related tax news
- **Avalara blog:** U.S. sales tax news and trends
- **VATlive:** International VAT and sales tax news
- **Sales tax laws by state:** A breakdown of sales tax laws affecting out-of-state sellers
- **Sales tax risk assessment:** Find out where you could be on the hook for economic nexus

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