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Foreign Companies Must Wade Carefully When Navigating SALT Rules

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State taxes are complicated, vary by jurisdiction, and change frequently. Foreign companies that do business in the US need to be aware of different states' requirements for collecting and remitting state and local sales taxes, says Marcum LLP's John Bonk.

Failing to collect and remit US sales tax can create direct tax liability for a company that does interstate business.

Forty-five states plus Washington, D.C., have a state-level sales tax on tangible personal property and specifically identified services. Many of them also have local sales taxes. The total tax rate can vary greatly but averages around 6% to 7%. Most states require just a single, combined return showing the calculation of both state and local taxes, due on a monthly, quarterly, or annual basis. Some states, such as Colorado and Louisiana, require separate local tax filings.

To be required to collect sales tax, a company must have nexus within the delivery state of the customer. For sales tax purposes, nexus is the state's ability to require collection because of a company's business connection to that state.

Foreign Company Exposure

Historically, foreign companies didn't have to worry about US sales tax implications because they needed a physical presence in a state to have nexus. That changed in 2018, when the US Supreme Court's *South Dakota v. Wayfair* ruling opened the door for states to adjust their sales tax rules, resulting in more states implementing sales and transactions thresholds to establish nexus. In these states, a physical presence is no longer the standard.

Wayfair was a major change for companies that make interstate sales of taxable goods or services. Many went to collecting tax in almost every state from only collecting sales tax in a few states. The addition of the sales and transaction thresholds also means that foreign companies with no physical presence in the US are now required to collect sales tax if they exceed the thresholds.

The most common and lowest threshold is $100,000, or 200 transactions in a 12-month period. Currently, the highest threshold—in states such as California and Texas—is $500,000 in sales.

Often, foreign companies rely on tax treaties between their countries and the US to govern US tax remittance. Tax treaties are agreements between two or more countries that aim to prevent double taxation and promote cross-border trade and investment.

These treaties usually cover various types of taxes, such as income tax, estate tax, and gift tax. However, tax treaties generally don't cover US sales tax. Because sales tax is a state-level tax and not a federal tax, it falls outside the scope of most tax treaties.

Sales Tax Registration

The process for sales tax collection and remittance for a foreign company starts with registering in the appropriate states. Registration can be done either online or via paper form and usually takes a few weeks to process.

A common issue for foreign companies is that sales tax registration requires a responsible individual to be listed on the sales tax account. Some states have strict rules requiring a US Social Security Number for that responsible person. Often, a foreign company without an SSN will use an Individual Taxpayer Identification Number—a tax processing number the IRS issues individuals not eligible for an SSN but who need to file taxes in the US.

If the company is unable to access either an SSN or ITIN, the registration process can be difficult, as not all states have updated their regulations to accommodate foreign companies needing to collect sales tax under the new nexus rules. Generally, direct contact with the state is required to complete the registration.

Once registered, the company will need to start collecting and remitting sales tax in states where it has nexus. Depending on the extent of its nexus, software may be needed to help apply the correct sales tax rates in multiple states and manage customer invoicing.

The remittance of sales tax returns can be burdensome and, therefore, is commonly outsourced. It's recommended to always include your accounting firm in your sales tax process and not rely solely on your software vendor.

Understanding Nexus

A foreign company unsure if it has US sales tax exposure should obtain guidance from a state and local tax professional. A SALT professional can review the company's nexus status, understand the taxability of its products, estimate the potential exposure, and offer

advice as to next steps. If a company has exposure, the adviser may suggest filing all past due returns or entering into a voluntary disclosure program.

Voluntary disclosure allows companies to file the prior three to four years of tax returns and pay the tax and interest due, in exchange for forgiveness of all prior years, with penalties waived. The taxpayer needs to be accepted into the program, which is usually a simple matter. The most common obstacle that can disqualify a taxpayer from acceptance arises if the state previously reached out to the taxpayer about potentially needing to register for sales tax.

At a minimum, a taxpayer should understand the exposure to their business as it relates to state sales taxes. State taxes are complicated, vary by jurisdiction, and change frequently. It shouldn't be assumed that income tax compliance teams are looking into a company's sales tax issues. Taxpayers should make sure they have relationships with tax teams that have specific SALT experience and can effectively address any issues or concerns.

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