

Direct-to-Consumer Shippers and Sales Tax:

What You Need to Know



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Foreword

Managing sales tax obligations across jurisdictions can be very difficult. Rules, regulations, filing requirements and reporting timelines vary significantly by state, making compliance time-consuming and complicated for DtC shippers.

Within the sales tax landscape, each jurisdiction can impose different sales tax rates, the taxability rules on alcohol or specific products can vary, and the forms for filing and remitting are modified frequently. It can be a lot to keep up with. Here is what you need to know about sales tax in order to compliantly ship alcohol DtC.

What is sales tax?

Sales tax is uniquely complex in the United States. It can be applied at every jurisdictional level: state, city, county and district—but without rate uniformity. State-level sales tax is collected in every state except for five, which are referred to as the NOMAD states: New Hampshire, Oregon, Montana, Alaska* and Delaware. (*Alaska does have sales tax at a local level, but there is no state-wide sales tax.)

There are three types of sales tax DtC shippers should be aware of: sales tax, seller's use tax and consumer's use tax.

- ➔ **Sales tax** is tax charged from the seller to the buyer, when the seller and the buyer are in the same jurisdiction. For example, someone goes into a winery and buys a set of glasses. That transaction is then subject to sales tax. The seller (winery) collects the tax, assessed as a percentage of the listed price, from the buyer (consumer) and then the seller remits it to the department of revenue in whichever state they are in.
- ➔ **Seller's use tax** is similar to sales tax, but would apply when the seller and buyer are in different jurisdictions. This is an important distinction because the rates at the city, county, and district levels could be different and may also need to be reported on different forms. So, when you think of interstate transactions, think of the application of seller's use tax. To continue the example above, if a winery in California sells that same set of glasses to a buyer in Massachusetts, the winery would remit seller's use tax.
- ➔ **Consumer's use tax** is a little different. Both sales tax and seller's use tax are remitted to the state by the seller, but consumer's use tax applies when the buyer remits tax themselves because the seller isn't otherwise obligated to remit the tax. But, as most DtC wine shippers have an obligation to collect and remit sales tax on their shipments, consumer's use tax has largely not been an issue for the market.



What are situs and nexus?

Situs and nexus are two concepts that help determine if a business is required to collect sales tax in a particular jurisdiction.

Situs answers the question: Which jurisdiction is entitled to impose tax?

By and large, “situs” means the location where the consumer takes possession of the goods. If you go to a package store to buy a bottle of wine and carry it out of the store, the transfer happens at the store and so the city, county, and state where the package store is located will be the taxing jurisdictions. For a remote sale, like a DtC wine shipment, that occurs at the consumer’s address, where they open the package of wine. Most states set up their DtC statutes to dictate that for tax purposes—the sale occurs at the deliver-to address. Situs is particularly important as it designates the tax rate that applies to the sale.

Nexus answers the question: Is the seller required to collect and remit tax at the location of situs?

“Nexus” means “connection,” the idea being that a business shouldn’t be obligated to pay a state tax unless it has a sufficient connection to that state. Until recently, the legal doctrine for sales tax was that “nexus” meant “physical presence”—unless a company physically benefited from being in that jurisdiction, like using their roads and infrastructure, then there wasn’t a sufficient enough connection for the state to burden the business. But, this standard changed in 2018 with the Supreme Court ruling in *South Dakota v. Wayfair*, where the Court decided that “physical presence” is too strict of a standard for the Internet age. Instead, the Court ruled that we would go back to a more general definition of “nexus” as “sufficient presence,” and gave a friendly nod to the law that South Dakota had in place, which had kicked off the case.

South Dakota v. Wayfair, economic nexus thresholds, and marketplace facilitators

So what was that law that has upended decades of doctrine of what “nexus” meant for sales tax? In 2016, South Dakota passed a law that any seller, no matter where they were located, with more than 200 transactions or \$100,000 in sales to South Dakota residents would now have nexus in the state, obligating them to collect and remit South Dakota tax.

This law was clearly in violation of the existing legal doctrine, but that was the point—the state was itching for the tax money and so prepared for an immediate legal challenge. Ultimately, the state won, and the Supreme Court overturned the previous “physical presence” standard in favor of a more lenient “undue burden” standard. So as long as a state’s rules weren’t unfair to a remote seller, the state could require them to pay sales taxes. While “unfairness” or “undue burden” wasn’t explicitly defined, the Court did indicate that South Dakota’s system—\$100,000 in annual sales or 200 separate transactions was probably what the Court would call “fair” if forced to say. Since then, every state but Missouri and Florida (and the NOMAD states that don’t collect sales tax) has established rules requiring remote sellers to collect sales tax.

Not every state followed South Dakota’s thresholds of \$100,000 in sales or 200 transactions, making things more complicated. Thresholds for determining if **a remote seller needs to collect sales tax vary between states**. Some states only use sales value threshold and don’t go off of transactions, while others like California and Texas use both but set a much higher sales value threshold (\$500,000). There is also a difference among states on whether the threshold only applies to retail sales, or to all sales in the state, including those at wholesale. States are starting to modify their original thresholds in order to include only high-value sellers with meaningful sales tax revenue while leaving out the small sellers that may be ill-equipped or unable to comply with the rules.

Further, many states have added new obligations on marketplace facilitators, like Amazon or Etsy, which provide online fora for sellers to sell their products to a nationwide audience. Many states now have a rule that marketplace facilitators, instead of the individual sellers, are liable for the collection and remittance of tax on sales made in the marketplace. There is a lot of complexity around this rule, particularly for businesses that use both marketplaces and their own platforms. However, for DtC wine shippers, these marketplace rules are less relevant as there are often **restrictions on when alcohol can be sold over through a third-party platform**.

What are the sales tax compliance requirements for DtC sellers?

There are four pillars to sales tax compliance: registration, calculation, filing and penalties.



Registration

Before a business can start collecting sales tax, they need to be registered with the state. This process can be challenging as the registration process varies and can be a time-consuming, manual process. Remote sellers need to be aware of the type of tax (seller's sales or use tax) that each state will require them to register for and report on.



Calculation

When trying to collect the correct sales tax, think location. The seller needs to know the customer's exact deliver-to address in order to properly assess and collect the correct tax rate.

There are over 12,000 tax jurisdictions in the United States, each with a different combined state and local tax rate. While some states apply a single rate across the state, many allow local communities—counties, cities, even “special tax districts”—to establish their own tax rates.

In addition, there are special tax rates and rules for wine shipped DtC. For example, New Hampshire as one of the NOMAD states doesn't have a sales tax. However, it instead imposes a state-controlled markup of 8%, which can be collected from customers at the time of purchase, much like a sales tax. And in Massachusetts, while alcohol sales would be subject to the sales tax, if the state excise tax is paid on the shipment of alcohol then sales tax is instead exempted. So, purchases in retail stores (and also for DtC shipments) are effectively tax exempt in Massachusetts, assuming the excise tax has been paid.



Filing

Filing is collecting and remitting tax. It may sound easy, but in fact can be very difficult. Some states provide simple returns, while for others, like Arizona or Colorado, it may seem like you need an engineering degree to complete. Even states that are moving towards online filings, which in theory are more straightforward, still require a lot of drawn-out manual processes to complete.



Penalties

As a taxpayer, you can be penalized for failing to meet the requirements for filing and remitting taxes. This means you can be penalized for, among other things, inaccurate calculations for rates and rules, failure to file, failure to pay, and/or filing late. Penalties, though, can differ significantly depending on if you are negligent versus having intentional disregard.

Further, states will assess interest on late payments, which is statutorily imposed and very difficult to get waived. For each of your late filings, you can rack up additional interest charges, which will get added to any penalties also levied against you. And then don't forget, you still have to pay the tax you originally owed! This all makes sales tax compliance very expensive if you don't get things right from the get go.

And states are looking to crackdown on gaps on sales tax collections. Technology enables states to easily find inaccuracies and impose penalties. If an auditor has a "productive" audit, meaning they come back with a lot of money in penalties and fines, they will continue to go back to that business knowing they are more likely to find other mistakes.

Here is an example of how costly penalties and fines can be:

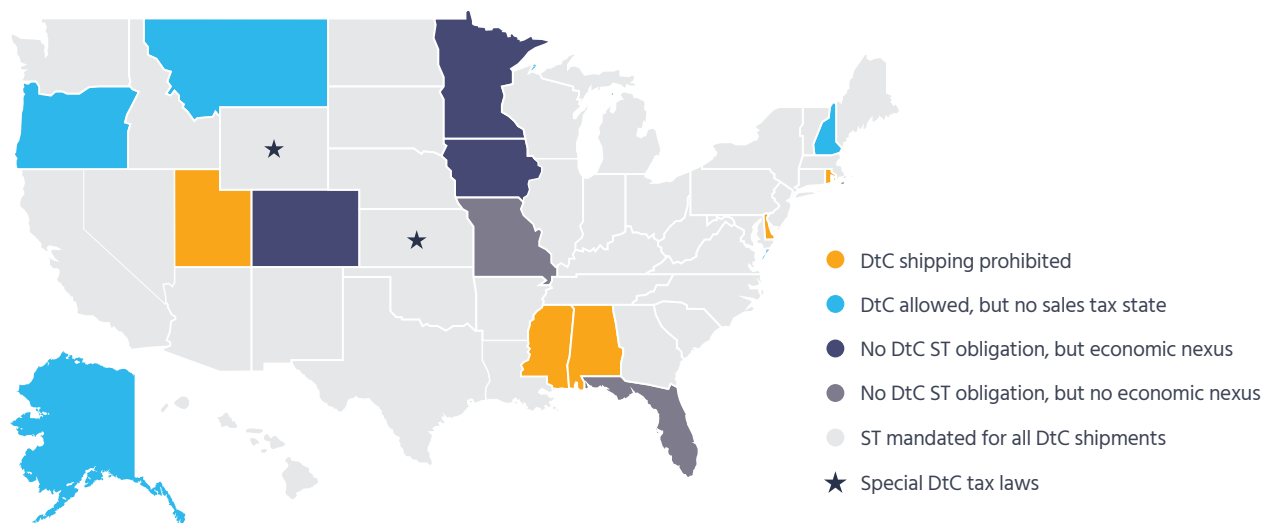
New York state's penalty fines

- **Late filing:** 5% of tax due per month, up to 25%
- **Late payment:** 5% of the unpaid amount per month, up to 25%
- **Wrong Calculation:** 10% of the difference between amount reported and amount owed
- **Negligence:** 5% of the difference between correct tax and reported tax
- **Fraud:** 2x the difference between correct tax and reported tax
- **Frivolous return:** \$5,000 on top of any other penalty

Special concerns for wineries selling DTC

While all of these generally-applicable rules are good to know, things can be a little different for DTC wine shippers. For one, most states require DTC shippers to accept a sales tax liability in order to receive a DTC shipping permit. This has long applied, well before the Wayfair decision. Because of this, DTC shippers are well ahead of other remote sellers in managing multi-state tax liability. It also means that failure to pay sales tax can affect not only your bottom line in terms of penalties and interest, but a state can decide to revoke or not renew your DTC license if they determine you are failing to properly collect and remit sales tax.

The DTC Shipping Map for Wineries



Since most DTC shippers’ tax liabilities arise from them holding a DTC shipping license, they need to know whether there are unique rules that apply to their special circumstances or when generally-applicable rules would prevail instead. For instance, Louisiana’s DTC laws obligate DTC shippers to only collect and remit state tax, but not any local taxes (this was because Louisiana local taxes are notoriously difficult to manage, so a compromise was reached). DTC shippers selling into Louisiana have only needed to collect and remit the state tax (and use a unique DTC shipping sales tax return). However, in July 2020 **Louisiana adopted economic nexus rules** in an attempt to get more local tax revenue. So DTC shippers that also meet the economic nexus threshold (\$100,000 in annual sales in Louisiana) now also face this generally-applicable obligation, and need to also collect and remit any local taxes.

It is these kinds of nuances and variations that makes sales tax compliance so difficult to manage, and brings added complexity to DTC wine shippers.

How to manage it all

Compounding the complexity of the sales tax landscape for DtC shippers, almost everything is subject to change. States are not always diligent in informing taxpayers of changes in rates, forms and rules that might affect them. All of these factors can make it seem overwhelming to manage sales tax.

This is where technology can help. Implementing real-time sales tax determination software can help ease the burden of keeping up with the latest sales tax rules and regulations. With **real-time sales tax determination**, you can rest easy knowing that you are collecting, and then remitting, the correct tax, down to the street level. Having all the special rules, markups and regulations applied in real-time can help you ensure compliance and a smooth and seamless purchasing experience for your DtC customers.



See how ShipCompliant can help
you with your shipping compliance
and management.



About Sovos ShipCompliant

Sovos ShipCompliant has been the leader in automated alcohol beverage compliance tools for more than 15 years, providing a full suite of cloud-based solutions to wineries, breweries, distilleries, importers, distributors and retailers to ensure they meet all federal and state regulations for direct-to-consumer and three-tier distribution.

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