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US sales tax rules explained

A practical guide for European companies



US sales tax rules explained: a practical guide for European companies

US sales tax rules are complex and significantly different from those in Europe.

For European companies selling goods or services in the United States, or planning to enter the market, understanding how sales tax works is essential.

European businesses operating in the US need a general understanding of how American sales tax works, including where and when it applies.

Without this, companies risk unexpected tax exposure, penalties, and compliance issues. Here's what you need to know.

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US sales tax is imposed at the state level

The US does not have a federal sales tax. Instead, each individual state sets its own sales tax rules and regulations.

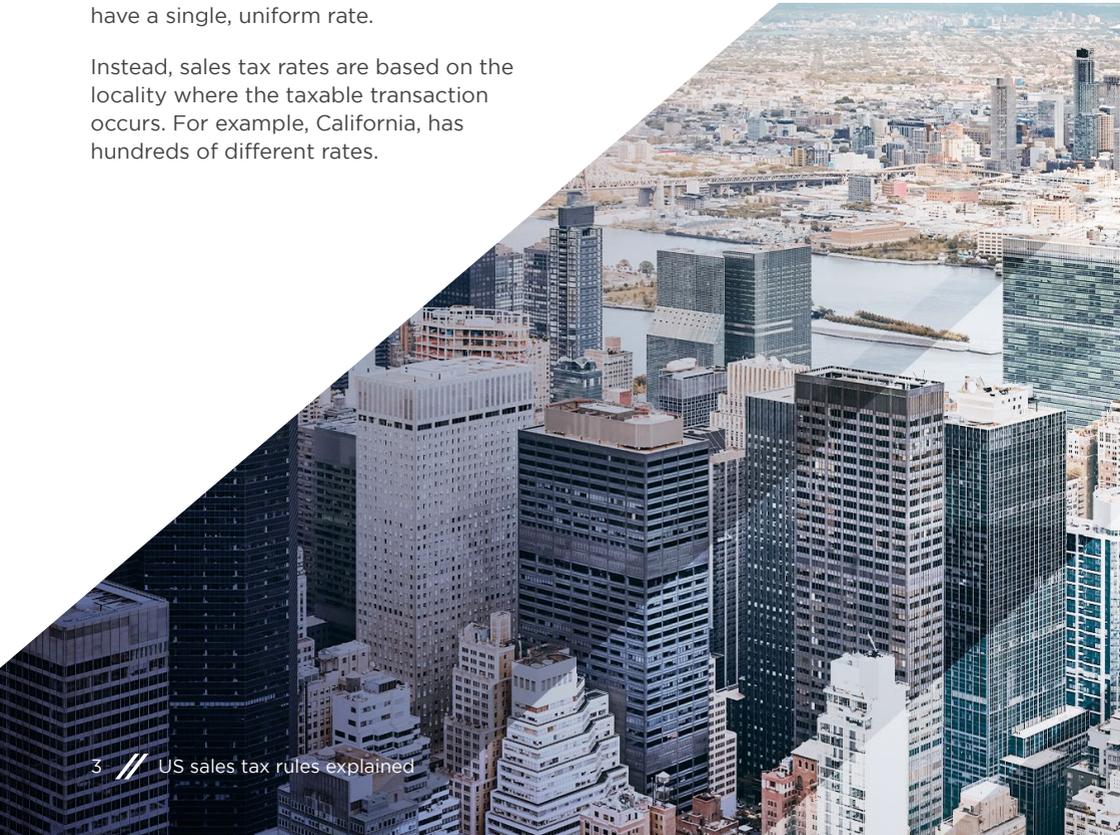
As a result, if you are selling services and goods across the US, you may need to deal with up to 46 unique state tax systems. 46, not 51, because five states (Alaska, Delaware, Montana, New Hampshire, and Oregon) do not impose a sales tax.

Beware that sales tax rates differ from state to state, and so do the sales tax filing deadlines, which can add another layer of complexity.

Most states with a sales tax have local rates

In addition to the 46 different sales tax systems, the majority of states do not have a single, uniform rate.

Instead, sales tax rates are based on the locality where the taxable transaction occurs. For example, California, has hundreds of different rates.



The NEXUS concept limits a state’s ability to impose its sales tax law

A NEXUS generally means a connection. Among tax professionals, the term NEXUS describes a situation where a business has a sufficient tie to a state, either “physical” or “economic”, that creates a tax obligation.

“Physical” NEXUS can arise from having a physical office, storing inventory, or employing one person in a given state.

Since the 2018 Supreme Court decision in *South Dakota vs. Wayfair Inc**, the majority of states have also adopted the “economic” NEXUS criteria to determine whether a business that makes remote sales must collect and remit sales tax in their state, even without a physical presence.

The “economic” NEXUS is typically based on the volume of sale transactions, and/or the total revenue generated from clients located in that state. Importantly, the “economic” threshold varies by state.

** In the June 2018 South Dakota vs. Wayfair Inc. case, the US Supreme Court decided that any company with at least 200 sale transactions or \$100,000 in sales in a given state, must collect sales tax in that state. As a result of this ruling, a growing number of states started to disregard the “physical presence” NEXUS standard for sales tax purposes, and instead considered the “economic” NEXUS criteria to determine whether a non-resident business that makes remote sales should collect and remit sales tax in their state.*



Online marketplaces must collect sales tax on behalf of sellers

Although the sales tax is generally charged and collected by the seller, most states now require that companies operating as online marketplaces (such as Amazon, or eBay) collect sales tax on behalf of the actual seller

US sales tax is not a value added tax (VAT)

US sales tax is imposed only once on the final consumer, while the value added tax (VAT) that most European companies know is a transaction tax collected at every step of production and distribution

Bilateral tax treaties do not apply to state sales tax

Federal tax treaties between the US and foreign countries, which can limit the federal government's ability to tax foreign companies, do not apply to state taxes.

As a result, even if a foreign entity is exempt from US federal income tax under a bilateral tax treaty, it could still be subject to sales tax rules of individual states.



How ZEDRA can help

For European companies looking to expand their business operations into the United States, it is important to have a clear understanding of US sales tax rules, which vary by state. Missteps can lead to significant financial exposure, penalties, compliance issues, or a failed audit in a due diligence.

To gain additional advice about the sales tax landscape in the US, contact Raphaël de Roubin.

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