

A finance leader's sales tax guide for SaaS business



Table of Contents



A Finance Leader's Sales Tax Guide For Your SaaS Business	1
An Overview of SaaS Sales Tax in the US	2
The Difference Between Sales Tax And Use Tax	3
The Importance of Sales Tax Compliance for SaaS Companies	4
The Consequences of Non-Compliance	5
The Benefits of Sales Tax Compliance	6-7
Types of SaaS Nexus	8-9
States Generally Exempting SaaS from Sales Tax	10-12
Sales Tax Registration for SaaS	13-14
Managing Sales Tax Exemptions and Resale Certificates	14-15
Sales Tax Collection and Remittance	15
Common pitfalls when calculating sales tax	16
Summary	17-18

A Finance Leader's Sales Tax Guide For Your SaaS Business

An Introduction to US Sales Tax for SaaS Businesses

We often hear about the complexities of US sales tax, and unfortunately, if you're a SaaS (software as a service) business owner, the odds aren't necessarily stacked in your favor. Of course, this is if you plan on tackling your sales tax obligations by yourself. Fortunately, sales tax for SaaS doesn't have to be daunting, at least not when you've got experts to show you the ropes! In this all-you-can-read buffet, we're touching on all the most important aspects of US sales tax and how it applies to your business.

With this guide in your arsenal, you'll be able to:

- ✔ Gain a comprehensive understanding of your sales tax obligations.
- ✔ Equips your SaaS business with the knowledge to accurately identify and fulfill its tax obligations, avoiding legal pitfalls and financial penalties.
- ✔ Discover practical compliance strategies for optimal efficiency.
- ✔ Understand how sales tax obligations evolve with business growth, including considerations for startups, scaling businesses, and mergers and acquisitions.

Let's dive in!

Here's what you need to know. First up?
The basics!



An Overview of SaaS Sales Tax in the US

In a nutshell,
albeit hard to crack, sales tax is the tax
applied to selling goods and services.
But here's where things
get tricky:

SaaS sales tax is about as complicated as tax gets. **Why?** Well, this has mostly to do with its classification. Is it a service, a product, or software? The complexities arise from these classifications because each state in the USA attempts to adapt its tax legislation to the evolving digital landscape. But we'll get to that in a second.

For now, Sales Tax for SaaS refers to the following:



SaaS Sales Tax:

"A tax imposed on the sale of Software as a Service (SaaS) products, which are cloud-based services delivered over the internet. The taxability of SaaS varies by state, with different states having distinct rules and regulations on whether and how these digital products are taxed."

As a SaaS business, it is your responsibility to ensure you know which states require you to pay sales tax. This tax obligation is referred to as a "nexus." However, as mentioned above, each state has its own sales tax laws and rates in the United States, which can be confusing for businesses operating across state lines or just starting out.

Before continuing down the SaaS sales tax rabbit hole, it's important to first establish what it is NOT. Ergo, it's not use tax—and here's the difference.

The Difference Between Sales Tax And Use Tax

Both sales tax and use tax are known as 'indirect' taxation. The critical difference, however, is that sales tax is a **single-stage tax**. This means that sales tax is charged only once at the retail sale to the final consumer. This tax is added to the sale price, making it visible to the consumer at the time of purchase. On the other hand, **use tax** is generally applied when you use, store, or consume items you bought without paying sales tax, usually from out-of-state vendors.



A practical example:

Suppose you're a SaaS founder who offers a project management tool to customers in your home state. The customer subscribes to your service for \$50 per month. Great! However, you have a sales tax obligation in this state, which means you must collect a 7% sales tax at checkout, making the total cost to the customer \$53.50. You then remit the collected sales tax to your state's tax authority. **Voila!**

A few days later, you sell the same tool to a customer in a different state where you do not have a sales tax nexus. Okay, **now what?**

This is where use tax plays a role. As you are exempt in that particular state, you do not collect sales tax on the \$50 subscription fee. The customer, however, is responsible for reporting and paying a 7% use tax on the \$50 to their state, amounting to \$3.50.

If you'd like to explore this topic further, we recommend reading our article "Sales Tax vs. Use Tax: Unraveling the Differences." But for now, let's stay on track and shift our focus back to Sales Tax and why it's so important for SaaS companies in the first place.

The Importance of Sales Tax Compliance for SaaS Companies

Now, when it comes to understanding (and navigating)

the SaaS sales tax landscape, it's essential to understand both the consequences and advantages of sales tax compliance.

However, balancing the two is quintessential to mastering your sales tax obligations. **How so?** Well, focus too much on the consequences, and you're left with fear, uncertainty, and doubt as the main driving force behind your tax posture, which is both draining and unsustainable.

On the flip side, focus too much on the advantages of healthy compliance, and you may miss critical updates or gaps, leading to exposure. So, to help navigate the landscape,

here's the full map!

The Consequences of Non-Compliance





You're looking at financial penalties

If you're required to collect sales tax and you don't, there is little to no grace, even if you're a SaaS trying to figure out the ropes. Simply put? Failing to meet your sales tax obligations (collecting and remitting) can expose your SaaS to fines, interest charges, and state-specific penalties.



There will be legal repercussions

Unfortunately, the consequences of non-compliance go beyond financial penalties. Legal repercussions vary by state but could result in legal action by state tax authorities. Additionally, businesses may face audits and investigations, which can be time-consuming and costly. Lastly, in cases of persistent non-compliance, businesses could face lawsuits and potential business closures.



Non-compliance could lead to operational disruptions

As a scaling SaaS business, you can't afford operational disruptions due to compliance issues. Addressing compliance issues can divert resources from core business activities and eat at your capacity and resources. Not only does it stunt your growth, but it can put a nasty dent in client loyalty and trust.



Loss of business opportunities

Non-compliance may disqualify your business from certain contracts or partnerships. Potential investors or acquirers may view non-compliance as a red flag, affecting funding and acquisition opportunities. Moreover, customers may choose competitors who demonstrate better compliance and reliability—and rightly so!

Although the consequences of non-compliance should be taken seriously, it's important to note that it's not all doom and gloom.

The Benefits of Sales Tax Compliance

- ✔ **Boost customer trust and loyalty**
In a (very) competitive SaaS landscape, everyone is vying for the client's trust, loyalty, and overall approval. This becomes exponentially easier when you know you aren't operating with any compliance targets on your back, showing them that your business operates responsibly and transparently.
- ✔ **Mitigate unnecessary financial risks**
There will always be some risk when running a business. However, some risks are more important to prioritize and mitigate than others, with sales tax risks at the top of that list. Consistent compliance ensures accurate tax collection and remittance, reducing the risk of financial setbacks arising from non-compliance.
- ✔ **Leverage operational efficiency and scalability**
By conquering compliance and implementing robust sales tax compliance processes, SaaS businesses can effectively streamline operations, freeing up resources to focus on core business activities and growth initiatives. This naturally leads to the ability to scale operations, allowing SaaS businesses to expand into new markets confidently without being hindered by tax-related complexities.
- ✔ **Gain a competitive advantage**
Did you know that 75% of companies consider tax compliance a critical factor in choosing a SaaS provider? This is a no-brainer, and compliance with sales tax regulations is a surefire competitive differentiator, especially in industries where trust and reliability are paramount.

Okay, great! You're confident in WHY you should comply with your sales tax obligations. The next step is HOW, exactly?

Understanding Your Sales Tax Obligations. Hello, Nexus!

As a SaaS business, the chances are incredibly high that you're selling your service across multiple state lines. Therefore, you must understand which states you have sales tax obligations in and where you do not. This sales tax connection (or obligation) you have in a state is called a "Nexus."



Nexus:

the sufficient presence a SaaS business establishes in a state, triggering the obligation to collect and remit sale tax. For SaaS companies, Nexus can be established through various means, such as having employees, offices, or significant sales activity in a particular state.

Simply put,

your Nexus is the invisible string that ties you to that state (and all its accompanying sales tax requirements).

However, as a SaaS, determining whether or not you have triggered a Nexus can be especially challenging, considering the varying classifications of a SaaS. But complicated doesn't negate its importance, so let's start with the types of Nexus that a SaaS can trigger.

**Types of
SaaS Nexus:
Physical, Economic,
and Affiliate**





Physical Nexus:

Businesses can trigger a physical nexus based on the literal location of their business and employees (ergo, physical presence). Often, SaaS companies overlook this Nexus as they do not necessarily operate from physical premises. However, there's much more to the matter. For SaaS in particular, key triggers that activate a physical nexus include:

- ✓ Your physical location in a state (office, home office, co-working space, warehouse, server equipment, or data centers).
- ✓ You have out-of-state employees (including remote employees) that work in a nexus state.
- ✓ Your employees are temporarily in a location for business purposes such as trade shows, events, or conferences.



Economic Nexus:

Economic Nexus for a SaaS business refers to the presence or connection established solely based on economic activity within a state, such as sales revenue or transaction volume, regardless of physical presence. In other words, if a SaaS company exceeds certain thresholds of sales revenue or transactions in a state, it may be deemed to have economic Nexus and thus be required to collect and remit sales tax in that state. Economic nexus laws vary by state and are important for SaaS businesses operating across multiple states.

- ✓ Your SaaS business surpasses a specified threshold of sales revenue within a state, typically annually or quarterly.
- ✓ You conduct a predetermined number of transactions, such as sales or subscriptions, within a state over a defined period.
- ✓ You reach a set threshold based on the total gross receipts or income earned from sales within a state, encompassing both taxable and nontaxable transactions.

Affiliate Nexus:

An affiliate nexus for a SaaS business typically involves an agreement where the affiliate, such as a website or marketing partner, promotes the SaaS products in exchange for a commission or other compensation. Suppose the affiliate operates where the SaaS business has no physical presence but meets certain criteria. In that case, it can trigger a nexus, requiring the SaaS business to collect and remit sales tax in that state. Affiliate nexus laws vary by state and may include specific thresholds or criteria for determining Nexus. Key triggers include:

-  Establishing agreements with affiliates or third-party entities in a state to promote the SaaS products in exchange for commissions or other compensation.
-  Reaching specific thresholds for sales generated through affiliate referrals within a state may vary depending on the state's laws and regulations.
-  Conducting marketing or advertising activities in a state through affiliates, including online advertising, email campaigns, or other promotional efforts that target residents of that state.

Needless to say, there are many ways that your SaaS can trigger a nexus, emphasizing that no business should consider themselves 'under the radar' when it comes to monitoring and managing their sales tax obligations. However, before confirming your Nexus, another crucial point to consider is **the taxability of your SaaS products and services.**

States Generally Exempting SaaS from Sales Tax:



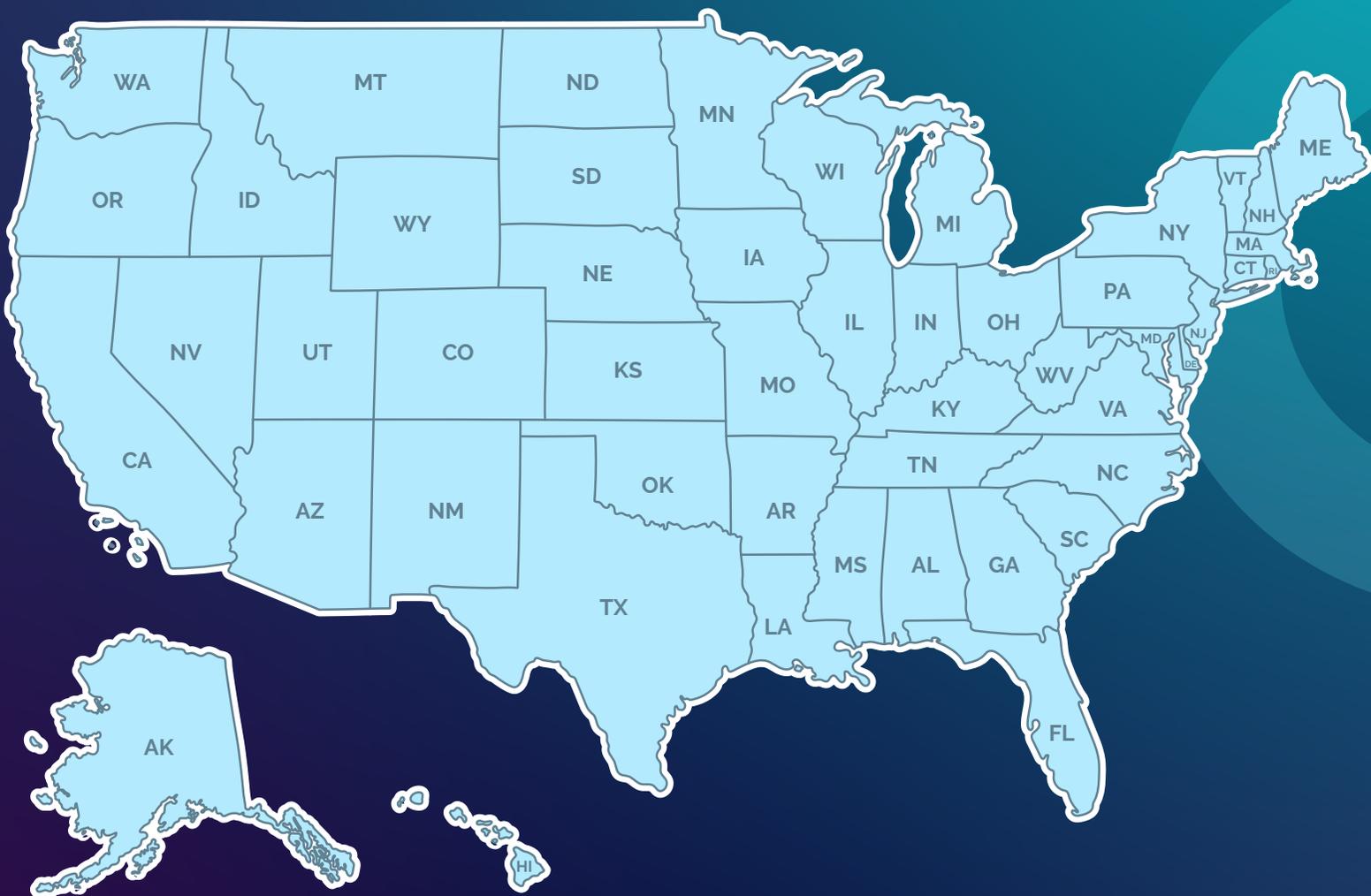
With over 12,000 taxing jurisdictions in the US, it can be difficult for SaaS companies to determine which states they must collect and remit sales tax in. This becomes increasingly challenging as some states consider your SaaS a taxable service, whereas others could exempt you from any obligations.

Here's an overview of what you need to know per state.



If you're a SaaS here are the states that tax you!

SaaS State-by-State Sales Tax Cheat Sheet



Alabama

Alabama considers computer software tangible personal property. It generally taxes digital products such as software, movies, music, and e-books but does not currently tax SaaS. The tax threshold: \$100,000 in annual sales or 200 separate sales transactions.

Alaska

Alaska can be tricky. Simply put, Alaska does not have sales tax on a state level (as it's part of the NOMAD states) but the local jurisdictions do impose sales tax where in some cases, SaaS might be subject to sales tax.

Arizona

SaaS is taxable in Arizona at a state-wide level and local tax rates apply. The tax threshold is \$100,000 in annual sales.

Connecticut

SaaS is taxable in Connecticut. SaaS for personal use is taxed at the full rate, but SaaS for business use is taxed at a lower percentage. The economic sales threshold is \$100,000, and the transaction threshold is 200.

Hawaii

SaaS and computer services are subject to taxation in Hawaii. The state's general excise tax is imposed on all goods and services unless they are specifically exempt from taxation. The economic threshold is \$100,000, and the transaction threshold is 200.

Iowa

Taxable at a rate that varies if for personal use. If for business use, then SaaS is exempt. Moreover, sales tax is applicable to the sale of specified digital products and certain digital services. Specified digital products include digital audio works, digital audio-visual works, and digital books. Digital services subject to sales tax include Software as a Service (SaaS), Infrastructure as a Service (IaaS), and Platform as a Service (PaaS).

Kentucky

As of January 1, 2023, SaaS is recognized as a taxable service (as long as it is delivered into the state).

Maryland

In Maryland, SaaS is taxable. However, SaaS intended for business use is exempt from sales tax. Take note that a number of digital services are exempt, though, and businesses should check in with the Maryland Comptroller's Office to determine the taxability of their services.

Massachusetts

Both SaaS and cloud computing are taxable in Massachusetts. Tax is charged regardless of the transfer of ownership. A word for the wise – Massachusetts is one of the states that have taken a firm and clear stance on SaaS taxability.

New Mexico

Yes. Custom and canned software and computer services are taxable. If your business sells SaaS to customers in New Mexico and meets the state's nexus requirements, you're obliged to collect and remit GRT on those sales. New Mexico defines both SaaS and cloud computing as services, making them subject to the GRT compliance requirements.

New York

SaaS is taxable in New York.

Ohio

The state of Ohio charges sales tax. However, there is an exemption when SaaS is employed for personal use.

Pennsylvania

Pennsylvania charges sales tax if the user is located within the state.

Rhode Island

All prewritten software, whether vendor-hosted or not, is subject to sales tax on SaaS.

South Carolina

In SC, SaaS is considered a communications service and, therefore, subject to sales tax.

South Dakota

Yes! In SD, electronically delivered software is considered tangible personal property.

Tennessee

Yes, SaaS is taxable in Tennessee. It is subject to sales and uses tax, irrespective of a customer's method of use, and is taxed at the base rate.

Texas

This can be a tricky one. SaaS is 80% taxable and 20% exempt in Texas, as they are considered part of a data processing service.

Utah

SaaS is subject to sales tax in Utah. The sales tax rate for digital services matches that for tangible personal property at the state level, plus any applicable local sales taxes. The economic nexus threshold is \$100,000 in gross sales or 200 separate transactions within the state in the previous or current calendar year.

Vermont

In Vermont, the sales tax laws have evolved to include certain digital services. These services are subject to the standard sales tax rate.

Washington

Yes, you must charge Washington SaaS sales tax on your sales to customers in the state. The economic nexus threshold for taxable transactions is \$250,000 or 200 transactions, with filing due dates set for the 20th of the month following the reporting period.

West Virginia

SaaS is considered a taxable service in West Virginia, with an economic sales threshold of \$100,000 and a transaction threshold of 200.

Sales Tax Registration for SaaS

For startups especially, **a few common sales tax registration slip ups** are easy to make but easy to avoid. So, if you're confident that you're about to trigger a nexus, or if you're rapidly scaling and want to iron out the sales tax processes before expanding across multiple states, here's what you need to know.

As soon as you've triggered a nexus, you must register in the relevant state and collect sales tax from the buyers there. But unfortunately, registration isn't as straightforward as a link that reads, 'Sign me up for sales tax.' As with everything sales tax related, all states have different requirements and rules regarding the registration process after you've activated your Nexus.

However, although the state-specific registration requirements may differ, there are a few core truths regarding collecting sales tax in the US.

The need for a valid US sales tax permit

You must obtain a valid US sales tax permit to collect sales tax legally. Initiating sales tax collection without a permit could be deemed tax fraud by some states.

Fortunately, many states offer online registration through their Department of Revenue. You'll receive your sales tax permit number instantly or within ten business days. If you opt for mail-in registration, processing may take 2–4 weeks. Here's some standard information you'll need when registering for a US sales tax permit:

- ✓ Your personal contact info
- ✓ Your business contact info
- ✓ Social Security number (SSN) or Federal Employer Identification Number (FEIN), also known as Employer Identification Number (EIN)
- ✓ Business entity (sole proprietor, LLC, S-Corp, etc.)

Once you have successfully obtained the required forms and sales tax permits from each tax authority's online portal to enable lawful sales tax collection, you may have to prioritize any missed tax obligations in the past; you can rectify this by filing for back taxes. Many states offer voluntary disclosure agreements (VDA), providing a means to declare any previously missed taxes without facing severe penalties.

Ultimately, the only way to ace the registration process is to understand the specific state laws and regulations where you're obligated to register. Fortunately, you don't have to take on that burden alone; check out our **State-by-State Sales Tax Guide Launchpad**.

What if you're exempt? Managing Sales Tax Exemptions and Resale Certificates

As many SaaS businesses could be considered exempt in specific states, it's important to remember that being exempt doesn't mean you're not exposed. All businesses must still manage and monitor their sales tax exemptions and resale certificates.

What are resale certificates, and why do you need them?

Resale certificates, sales tax certificates, reseller permits, or sales tax exemption certificates are state-issued documents that exempt buyers from paying sales tax on purchases from vendors, retailers, or wholesalers. These certificates are essential for ensuring that sales tax is only paid by the final consumer, allowing retailers and resellers to avoid paying sales tax on items they will resell or components that will be part of the final product. These certificates are crucial for SaaS businesses in managing tax obligations and ensuring compliance.

For example:



SaaS providers use these certificates to buy tax-free software or services when they intend to resell them as part of their offerings. The sales tax is collected when the SaaS product is sold to the end user.

Certain organizations, such as non-profits and those with 501(c)(3) status, can apply for sales tax exemption certificates. This allows them to use SaaS products without paying sales tax, as they are considered exempt final users.

In terms of compliance, managing exemption certificates is an absolute must. Moreover, evidence of this is essential for auditing purposes. SaaS companies must retain and provide these certificates to claim exemptions on purchases. Without them, the SaaS provider and the buyer may face penalties for non-compliance during an audit.

Sales Tax Collection and Remittance



You could absolutely master the entire Nexus and registration process, but there is always one crucial risk factor regarding consistent compliance—the sales tax calculations. As your SaaS begins to scale, your sales tax obligations start to resemble dozens of spinning plates, requiring a masterful balancing act in order to keep them from smashing into pieces.

However, every balancing act has its limit, and as you start to grow, so does your risk of exposure. Given the lack of a standardized rate, one of the most challenging aspects is ensuring you apply the correct rate to each transaction.

While nearly all 50 states levy sales tax, the rates and rules vary by state and local jurisdiction. Additionally, the applicable tax rate can depend on the specific type of product or service you offer.

Common pitfalls when calculating sales tax

-  **Ignoring Local Taxes**
Don't overlook local taxes, which can vary significantly within a state. Ensure your tax calculations include state, county, and city tax rates where applicable.
-  **Outdated Tax Rates**
Outdated tax rates can lead to incorrect tax calculations. Regularly update your tax rate tables or automated software to reflect current rates.
-  **Incorrect Nexus Determination**
Failing to determine where you have Nexus accurately can result in missed tax obligations or over-collection. Regularly assess your nexus status across all states.
-  **Misclassification of Products and Services**
Ensure that your SaaS offerings are correctly classified according to state tax laws. Misclassification can lead to incorrect tax applications.

Right. So what's the solution?

-  Double check sales tax type per state
-  Stay up to date with current laws and legislation
-  Automate your sales tax obligations

We get into this nitty-gritty in our piece, "**How can a SaaS error-proof their sales tax calculations?**"

Don't panic: let's recap



We get it—this is usually the point where everything tends to feel a tad (extremely) overwhelming. As a founder, you may feel too overwhelmed to open your SaaS product to the US market or hesitate to scale across state lines. Alternatively, you may feel panic, thinking you may be at risk for exposure and non-compliance. Fortunately, we're here to help.

Let's summarize your overall to-do list when managing your sales tax obligations.

Your Sales Tax Survival Checklist

Here's what you need to do

-  **Determine YOUR Nexus:**
Identify states where you have a physical and economic presence (offices, employees, etc.). Assess if your sales, revenue, or transaction volumes exceed state thresholds. Don't forget to review affiliate relationships that could establish Nexus in certain states.
-  **Identify Customer Locations:**
Map out your customers' locations and categorize them as B2C or B2B.
-  **Research State Tax Laws:**
Review sales tax laws and regulations in each state where you have Nexus.
-  **Understand Exemptions:**
Identify states with exemptions or exceptions for SaaS transactions.
-  **Classify SaaS Products:**
Ensure your products are correctly classified according to state tax laws.
-  **Register for Sales Tax Permits:**
Obtain sales tax permits in states where you have Nexus.





File Sales Tax Returns:

Prepare and submit sales tax returns promptly for each state.



Maintain Documentation:

Keep detailed records of all sales, exemptions, and tax payments. This includes acquiring and managing resale certificates for exempt purchases.

Now, rinse and repeat the process for every nexus state you trigger. Except you're not a compliance expert; even if you were, monitoring and managing your sales tax exposure is a full-time job. So, rather than have sales tax compliance cost you your resources, time, and peace of mind, we'd like to propose an alternative.

What if reading this guide is the most work you'll have to do on sales tax compliance?

At Complyt, we take over the sales tax burden so you can yield the benefits of consistent compliance. In simple terms, we do our job, so you can do yours (without worrying about sales tax exposure lurking in the background).

We automate the entire sales tax automation process from registration to remittance and everything in between. We also understand that there's no one-size-fits-all solution for compliance. There's hardly any standardization. That's why we also rope in the help of dedicated sales tax experts who help you manage the day-to-day sales tax obligations and automate the rest!

**Scale your SaaS without
growing sales tax exposure**

Book a demo!