Step-by-Step Guide to SALT Compliance for SaaS Companies

Tax obligations can be extremely complex, especially for SaaS companies. The tech M&A frenzy over the past few years has led SaaS companies to rapidly scale and expand, and in many cases, their SALT compliance has fallen behind their high-speed growth.

Looking ahead, tech companies expect that employees working from home will further complicate their tax obligations. According to BDO's [2023 Technology CFO Outlook Survey](), tech CFOs expect state taxation of digital services and tax obligations for out-of-state workers to have the largest impact on their organizations' total tax liabilities in the next two years.

It is critical that SaaS companies not only ensure they are addressing compliance gaps from prior acquisitions and expansions but are also ready to address tax implications of future or planned growth. As states continue to hire personnel to focus on tax enforcement, it is imperative that companies act now to analyze their tax liabilities and go-forward compliance.

01 Determine Nexus and Filing Obligations

02 Evaluate Product and Service Taxability

03 Quantify Potential Tax Exposure

04 Mitigate and Disclose Historical Tax Liabilities

05 Maintain Compliance

01 Determine Nexus and Filing Obligations

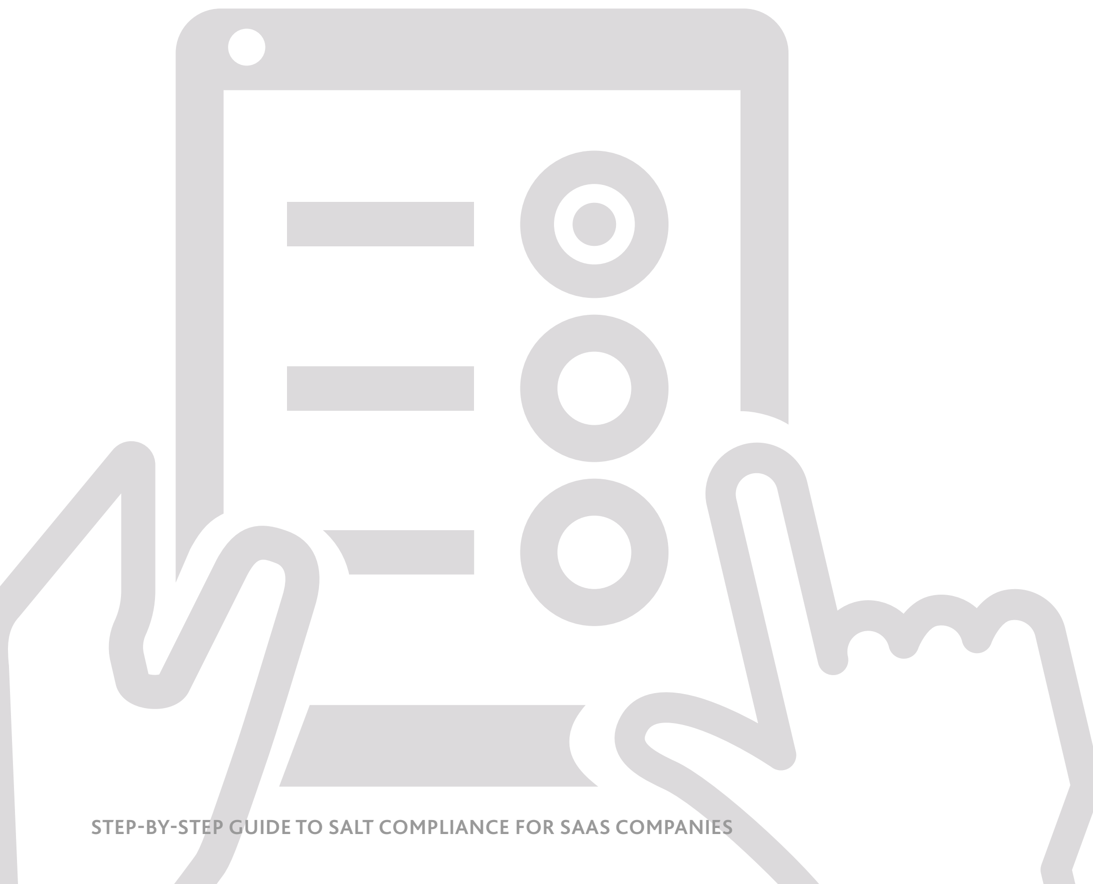
Compliance starts by reviewing a company's activities in every state and determining if there is a filing obligation based on each state's nexus standards. A company should understand crucial information:

- Where does the company have physical locations, and how many employees are at each location?
- In which states are remote employees or independent contractors located, and what portion of payroll is allocated to employees in those states?
- In which states are products and services being **purchased** by customers?
- In which states are products and services being **used** by customers?
- What is the sales revenue, and what is the nexus threshold, for each state?

REVIEW THE ECONOMIC NEXUS STANDARDS FOR EACH STATE WITH BDO'S STATE-BY-STATE MAP OF NEXUS THRESHOLDS.

02 Evaluate Product and Service Taxability

Once a company establishes its nexus profile, the next step is to determine the state sales tax treatment of its products and services:



- What is the nature of each SaaS offering: a product (the actual software) or a service (a provision that enables access to software)?
- In looking at customer location by state, what offerings are subject to sales tax?
- Are there any available exemptions or deductions (for example, are any services classified as nontaxable services rather than SaaS)?
- What are the sourcing rules for sales tax in each applicable state for each offering? Those rules determine how taxes are applied based on factors such as customer location and where software is accessed or used.

Invoices should be as detailed as possible to determine taxability more accurately. They should include detailed line items for each product sold or service rendered. Remember that support, maintenance, and training are taxed differently, so they will need to be broken out separately. Companies should consider using shipping information, which might not correspond to the invoice bill-to address, to reflect where the software is being accessed or used.

03 Quantify Potential Tax Exposure

After a company determines in which states it has nexus and which products and services are taxable in those states, it should quantify its outstanding and potential tax exposure so it can establish priorities for remediation. Some companies will also need to record that exposure for financial reporting purposes. Key considerations for determining exposure include:

- When was nexus established in each state?
- How would each product and service have been taxed in each state?
- How far back does exposure go?
- Which states have the strictest penalties for noncompliance?

04 Mitigate and Disclose Historical Tax Liabilities

Once exposure estimates are complete, a company should determine a course of action for mitigation and disclosure. Remittance strategies will vary by state, but reducing tax exposure should include the following considerations:

- In which states could customer documentation (for example, exemption certificates or proof of use tax payments) help reduce the company's historical tax exposure?
- What states offer amnesty or voluntary disclosure programs that could limit the number of years of back taxes owed and/or penalties and interest?

05 Maintain Compliance

Determining tax exposure and mitigating liabilities can be a time- and cost-intensive process. Companies should put proper procedures in place to maintain compliance despite changes in state tax laws:

- Develop monitoring and compliance procedures, including for sales tax collection and remittance, maintain accurate records, and conduct periodic reviews.
- Invest in tech solutions like automation and compliance software to streamline compliance and avoid additional exposure risks.
- Engage an external partner to develop strategic, cost-effective processes that minimize compliance costs and enable tax departments to focus on higher-value initiatives.

SEE WHAT ACTIONS TECH CFOS ARE TAKING REGARDING STATE SALES AND USE TAX CHANGES IN BDO'S 2023 TECHNOLOGY CFO OUTLOOK SURVEY.

CONTACT BDO TO DISCUSS HOW YOUR COMPANY CAN BEGIN THE TAX COMPLIANCE PROCESS.

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