Insights: Publications

5 Key Takeaways | Salt Update: Navigating the Complex Landscape of Sales and Use Tax Sourcing

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Chicago SALT Partners **David Hughes** and **Jordan Goodman** recently provided a SALT update during their webinar on **"Navigating the Complex Landscape of Sales and Use Tax Sourcing**" with AGN International. This webinar offered a comprehensive overview of the current rules and nuances of sales/use tax sourcing rules across states, emphasizing the challenges of sourcing tax for digital goods and services, software, mobile property and multi-state transactions.

Read their 5 Key Takeaways here:

1. Constitutional and Legal Framework for Tax Sourcing
Sales and use tax sourcing is governed by key constitutional standards, notably the Commerce Clause, as clarified in cases like *Complete Auto Transit v. Brady* and *South Dakota v. Wayfair*. These standards focus on establishing a substantial nexus, fair apportionment, non-discrimination, and a clear relation to the services provided by the state. The rules apply to both domestic and, with some additional factors, foreign commerce situations, as seen in *Japan Line Ltd. v. County of Los Angeles*.

2. Sourcing Rules Depend on the Type of Product or Service
The characterization of the item or service being sold (tangible personal property, software, or services) is critical to determining tax sourcing. Tangible personal property often uses a destination-based approach, while services may be sourced by the location of benefit or performance, depending on state-specific rules. Software and digital goods can present unique challenges, with some states treating them as tangible property and others as services.

3. Complexity and Variability of State Sourcing Rules
There is significant variation among states regarding how sales of goods and services are sourced for tax purposes. States may use destination sourcing, origin sourcing, or mixed approaches, and the rules often depend on the facts of each transaction. Multi-state transactions, such as software licenses or consulting services delivered across several states, require careful allocation and documentation to ensure compliance.

4. Allocation and Documentation Requirements for Multi-State Use
When products or services are used in multiple states, proper allocation and documentation become essential. States may permit or require apportionment based on usage, and sellers or purchasers may need to provide affidavits, user lists, or exemption certificates. The approach must be reasonable, consistent, and well-

supported to satisfy auditors and minimize risks of assessments or penalties.

5. Evolving Practices and Audit Considerations
State tax authorities are increasingly scrutinizing IT contracts, software licenses, and digital transactions. Auditors may demand detailed records on allocation methods, user locations, and contract terms. Best practices include systematic documentation at the time of transaction, using software to track usage, and ensuring that allocation methods are lawful, correct, and consistently applied across jurisdictions.

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