‘Returnuary’ is Coming: Stay Agile on Tax in Preparation

Like every other facet of modern life, COVID-19 is remaking the holiday shopping season. Between supply chain disruptions, shipping delays and continued social distancing measures, consumers are again looking at a holiday shopping season marked by shortages, unable to get their hands on coveted gifts.

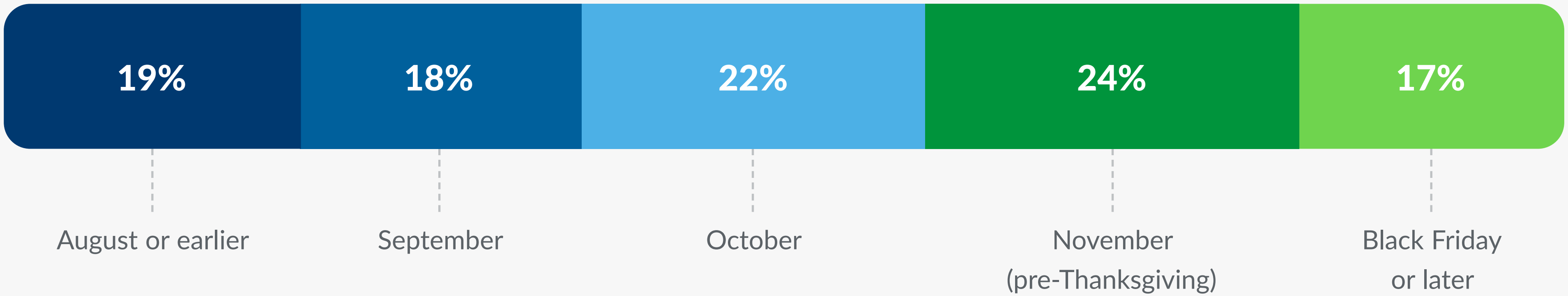
That's why for many, holiday shopping started well before the leaves turned colors and pumpkins were placed on doorsteps. Some even began shopping over the summer, though the majority started before November.

Like last year, most shopping took place online despite the reopening of brick-and-mortar stores. Shoppers have grown used to ecommerce during the pandemic, and they don't plan to change their shopping habits anytime soon.

2021 holiday sales will top **$1.3** billion, a **7%** to **9%** increase from last year.

Source: Deloitte

When will consumers start their holiday shopping?



Source: RetailMeNot

COVID-19 holiday shopping season has retailers bracing for "Returnuary."

By some estimates, retailers experienced 10 years' worth of digital transformation in the first three months of the coronavirus pandemic alone. According to a McKinsey report, brick-and-mortar shopping, though on the upswing, is not likely to go back to pre-pandemic levels.

When all the holiday treats are eaten and the wrapping paper is discarded, shoppers will partake in another holiday tradition, returns. This year, given the surge in ecommerce, retailers are bracing for more returns than ever, dubbing the beginning of the year "Returnuary."

"Ecommerce generates two-to-three times the number of returns compared to in-store," says Michael Simoncic, Managing Director of global business services firm Alvarez & Marsal. And some online purchases — particularly in apparel, auto parts and home goods — have a higher return rate than goods bought in store.

Returns cost retailers about **$5** per **$100** of item value.

Source: Appriss Retail

“With ecommerce, consumers can’t touch and feel a product until they get it, and then maybe they don’t like it, or it doesn’t fit,” says Peter Olanday, Retail Practice Leader, Vertex. “So, people will buy three of the same item and return the ones they don’t like.”

Interestingly, returns aren’t just an ecommerce problem. According to Appriss Retail, retailers also reported significantly more returns in-store during the pandemic, likely due to shuttered dressing rooms and changing return policies.

“But what may seem like a simple return to your local UPS store can be problematic for retailers on the backend,” Olanday says.

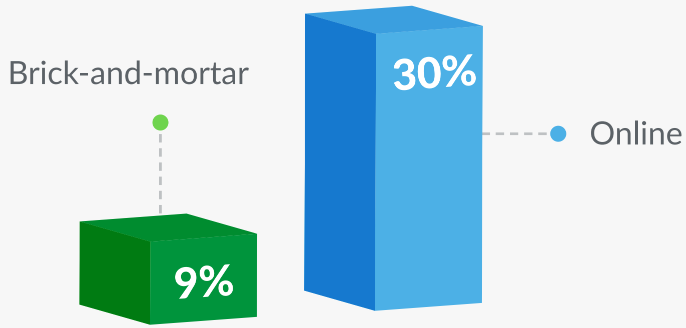
Total U.S. Ecommerce Sales For Q2 21

$223B

Up 3% from Q1

Source: U.S. Census Bureau

Higher return rates



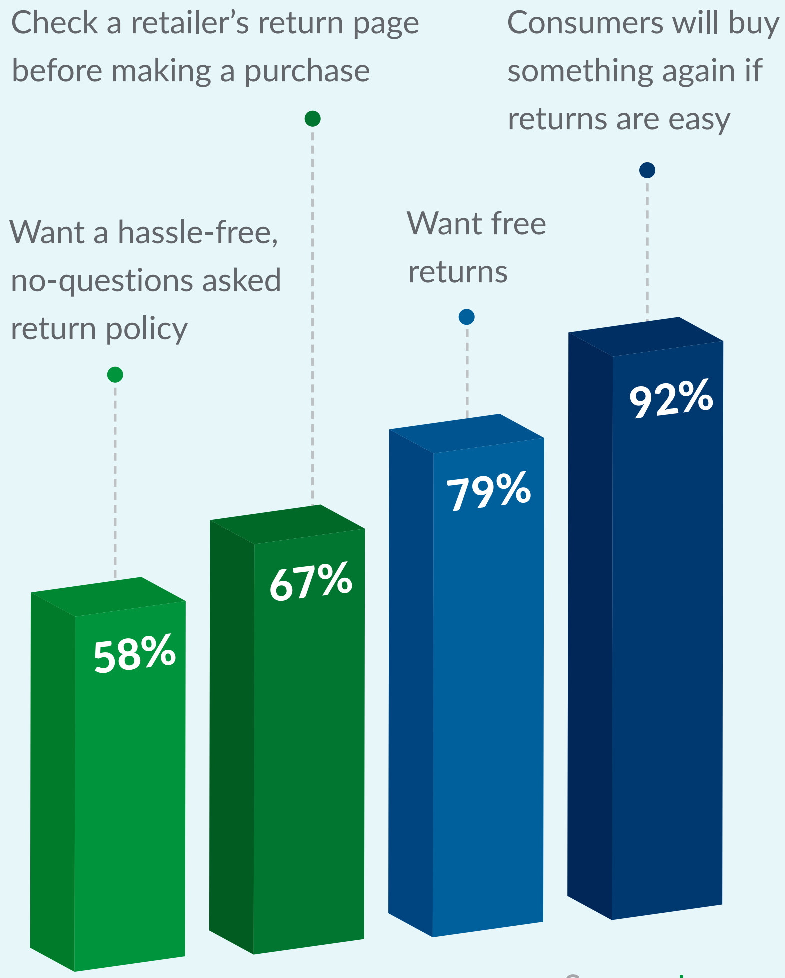
Source Invesp

Inevitable returns provide a growth opportunity for retailers.

The good news: “Return policies and practices actually drive sales,” Simoncic says. “Without an easy return policy, the customer avoids the purchase, so there’s a certain amount of revenue you leave off the table by not having easy returns.” In fact, big-name brands such as Zappos and L.L.Bean have led the way in leveraging more generous return policies to build loyalty.

Forward-looking retailers use returns to drive growth and position them to generate future sales. According to Mark Mathews, Vice President of Research and Development and Industry Analysis for the National Retail Federation: “Retailers view the return process as an opportunity to further engage with customers, as it provides additional points of contact for retailers to enhance overall consumer experience.”

Easy return policies also meet the ever-changing expectations of today’s shoppers:



Source: Invesp

Along with growth, returns bring retailers two big headaches: restocking and tax reporting.

Some items arrive back damaged or, in the case of merchandise like holiday décor, they come back too late to be restocked. Quarantining returned items also became a COVID-era practice with some retailers. As a result, items that can't be resold at full price often end up with resellers.

And tax reporting is already time-consuming and error prone. This year's longer ecommerce holiday shopping season only magnifies reporting issues.

"As customers shop earlier, returns become even more complicated, with more time between the purchase and return dates," Olanday says. "This widens the window where the tax rate at the purchase time can be different from the tax rate at the time of the return, requiring more attention on the historical rate of information."

Retailers using manual systems may struggle to keep up with the tax compliance requirements retailers face due to the acceleration of ecommerce and omnichannel sales. There are too many variables to keep track of, from changing tax rates to cross-border tax compliance. That's why automated tax determination engines that integrate with enterprise resource planning (ERP) solutions must become part of every retailer's toolkit.

13.3%

of the merchandise sold during the 2021 holiday season will be returned, equaling more than **$100 billion**.

Source: NRF

8 ways returns increase tax complexity.

The majority of states impose a state-wide sales tax, with a few notable exceptions. In some states, localities also charge a sales tax on top of the state sales tax. What is considered taxable also varies widely, with some states taxing certain types of clothing but not others. All these issues come into play and must be accounted for when a return occurs. Retailers must consider:

1. Shoppers must be refunded the tax they paid — at the time of the purchase

To calculate how much sales tax to refund, retailers must be able to pinpoint the exact tax that was paid at the time of the purchase based on tax nexus, otherwise known as historical tax rates.

What's troubling is that small retailers may not keep a database of historical tax rates for every jurisdiction where they are selling. "If I'm a retailer and I'm only keeping track of tax rates from today going forward, then I have no idea what the tax rate was 90 days ago when that purchase was made," Olanday says.

2. Different states have different policies about what's taxed and what isn't

With ecommerce, retailers must stay on top of all tax changes, even in places where they don't have a physical presence, in order to account for any cross-border taxes. This requires them to accurately assign tax nexus to each purchase: those with multiple locations may sell in more than one state, not just the state where the retailer resides. Not only are there different tax rates to calculate, but different states may tax items differently. Further, shoppers (or gift recipients) may return items in a different state than where they were originally purchased.

3. Multiple sales channels make it difficult to know where to report and remit tax

During the pandemic, buy online, return in-store (BORIS) became more prevalent as customers' homes became dressing rooms. Without good connectivity between sales channels, retailers may not have accurate visibility on the taxes owed, making it difficult to know where to report and remit sales tax. No matter if an item is purchased in a store, online, or a hybrid of the two, sales taxes must be collected consistently.

4. Multiple return options make tax obligations difficult to track

Modern retail is all about choice. Consumers don't pick one retail channel and stick with it throughout their retail journey. They want the flexibility to access the channel that is most convenient when they need it. The same is true with returns. Some shoppers will buy items online, then return them in-store. Others will return ecommerce purchases through mail. But that flexibility makes it difficult to track a retailer's tax obligations, creating inconsistencies. Add in returns on items purchased in marketplaces like Amazon and eBay and through delivery services like DoorDash, and the complexity just keeps growing.

5. Disconnected systems increase likelihood of inaccuracies

Further complicating matters is the fact that retailers may use different systems to handle different channels. They might use a point-of-sale (POS) system in-store but a content management system for their website or mobile app. Those systems don't always communicate with one other. As a result, retailers may be reporting tax incorrectly and could be vulnerable to fines in the event of an audit.

6. Regulations are constantly changing in thousands of jurisdictions

The Supreme Court's *South Dakota v. Wayfair* ruling means that nearly all online retailers have nexus in almost every state in which they sell. Therefore, ecommerce retailers and marketplaces must stay on top of constantly changing regulations in thousands of jurisdictions.

Even retailers who sell mainly through marketplaces (rather than directly to customers) must still deal with the issue of economic nexus. Some states require that retailers include marketplace sales in calculating their economic nexus, not just direct sales. Other states do not and it's incumbent on retailers to know which ones do.

7. Tax reporting isn't uniform across states, complicating accounting

In addition to the complexity of refunding sales tax to consumers, retailers must also be able to claim back the tax they reported and remitted. Again, the process isn't uniform across states. In some, sellers must amend past returns and in others, sellers can take a credit. Some retailers find this aspect of accounting too difficult and end up absorbing the refunded tax.

8. Governments need to generate revenue – and seek to do so through audits

Further making the sales tax burden more perilous is the fact that state and local budgets are straining under the weight of declining revenues and greater spending.

With sales tax making up as much as 42% of total tax revenues in some states, tax collectors are incentivized to unearth any potential unpaid sales taxes, while also generating revenues with penalties. Retailers should prepare for more audits of their sales tax collections in this environment.

Small and mid-sized retailers can't afford to get bogged down with the stress and potential economic fines of audits. Even with accurate sales tax reporting, companies may still get audited. But correct tax calculations can significantly reduce the errors auditors find. With fewer errors, retailers won't be penalized with fines.

"State and local governments are at the forefront of the response to the pandemic in their communities and will likely need to increase their typical spending to provide crucial public health services and help communities adopt to social distancing guidelines."

Source: Brookings

Common sales tax audit triggers

Prior sales and use tax audit

States typically keep track of entities that had significant deficiencies on audits in the past and target them for additional scrutiny.

Late filings

Habitually filing sales and use tax returns late gets auditors' attention.

Changes in sales tax laws

State sales tax laws change frequently, and errors can result when retailers are based in another state and are unaware of the changes.

Being a small business

Small businesses often lack the necessary resources to closely track sales and use tax rates, monitor changes, collect, and remit taxes accurately and on time.

Source: Accounting Today

How retailers can thrive in a world with more returns.

Smart retailers will develop strategies to encourage upselling and cross-selling during the return process. This can help minimize the cost of returns.

Another smart idea: adopting an integrated, modern, omnichannel approach to calculating and tracking taxes that meets consumers where they are. Relying on manual systems is too complicated and results in too many errors, which are both costly and time-consuming.

While many retailers combine ERP and POS systems to calculate tax, only an integrated and automated indirect tax engine is built to handle both the volume and complexity of retailers' modern-day tax challenges. Using such a solution to accurately calculate taxes can improve tax accuracy, reduce audit penalties, support business growth, reduce delays in vendor payments, and reduce costs.

Companies that are investing in new POS, ERP or procurement systems — or those that are changing their ecommerce platforms — can use that opportunity to introduce tax automation so they can scale their operations and achieve accurate and consistent tax calculation across all of their sales channels.

Vertex helps retailers spend less time on taxes and more time on growing their revenue.

As tax laws change and evolve, it's important to partner with a provider who will stay on top of the changing tax requirements and build them into solutions seamlessly. Manual sales tax may have been possible in a simpler tax environment, but the rapid pace of ecommerce makes that nearly impossible now. By implementing an integrated and automated indirect tax engine, retail organizations can spend less time on taxes and spend more time on growing their revenue during this holiday season and every holiday season to come.

Learn More

About Vertex

Vertex Inc., is a leading global provider of indirect tax software and solutions. The company's mission is to deliver the most trusted tax technology enabling global businesses to transact, comply, and grow with confidence. Vertex provides solutions that can be tailored to specific industries for major lines of indirect tax, including sales and consumer use, value added, and payroll. Headquartered in North America, and with offices in South America and Europe, Vertex employs over 1,200 professionals and serves companies across the globe.

About Retail TouchPoints

Retail TouchPoints and design:retail give all members of the retail world access to a vibrant community that combines insights, inspiration and opportunities to interact with their peers. We sit at theintersection of the art and science of retail strategy, providing granular data, high-value commentary, and aspirational success stories to help readers optimize customer experiences across all channels. Touching all facets of the retail ecosystem, including store experience and design, workforce management, digital marketing and engagement, and omnichannel optimization, our editorial content, multi-media resources and events take timely news and trends and transform them into tactical takeaways that meet the unique needs and priorities of our executive readers.

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