

Shipping and Sales Tax Explained

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Shipping and Sales Tax Explained: 5 Guidelines

For ecommerce sellers, knowing when to charge [sales tax](https://www.google.com/url?q=https%3A%2F%2Fwww.avalara.com%2Fus%2Fen%2Flearn%2Fsales-tax.html&sa=D&sntz=1&usg=AOvVaw0UClekxCykAxyhFMk8g65m) is complicated enough (stomach ulcers, anyone?). Add in shipping and handling taxability, and the problem gets thornier. As with everything sales tax, there are some general rules that can keep a company (mostly) compliant, but the exceptions cause more problems for those manually handling sales tax than most back offices can sort through. As more customers demand instant gratification, expectations of online sellers to shorten the gap between order and delivery increase. And that's on top of customer demand for inventory availability, free returns and shipping, and ship-to-store options. All of these are driving many retailers to test new approaches to the traditional supply chain. This brief addresses the particular sales tax challenges facing ecommerce retailers around the shipping and handling of consumer goods. Here are 5 guidelines to consider when determining whether to charge your customers sales tax on shipping and handling costs. This is even more critical with the holiday season on the horizon.

1. Nexus can (still) trip you up.

Determining whether or not to collect sales tax for sales made within your state, or out-of-state depends on nexus — the connection between seller and taxing jurisdiction that triggers a sales tax obligation. For ecommerce sellers in particular, determining nexus has grown increasingly difficult as states get trickier about requiring sales tax collections. Gone are the days of tax-free online shopping!

Watch for more (and more creative) definitions of nexus-creating activities through the rest of the year, and into 2015. And as we've seen, states always look for ways to expand the types of activities that create nexus to include the use of affiliate networks, distributors, independent agents, ad infinitum.

In the wake of legal battles with Amazon, Overstock and the like, many states are imposing sales tax obligations based on Internet affiliations between companies. So-called "click-through nexus" relationships catch some companies off guard.

States with current click-through legislation include: Arkansas, California, Connecticut, Georgia, Illinois, Kansas, Maine, Minnesota, Missouri, New York, North Carolina, Pennsylvania, Rhode Island, Vermont.

Knowing where your company has nexus is not easy for online merchants. Drop shipping can also create nexus in some states. Rules are complex, but mainly deal with the obligation to collect, so the question here is not directly about taxability of delivery charges, but rather who is obligated to collect tax and from whom?

2. State rules regarding shipping taxability are difficult to track.

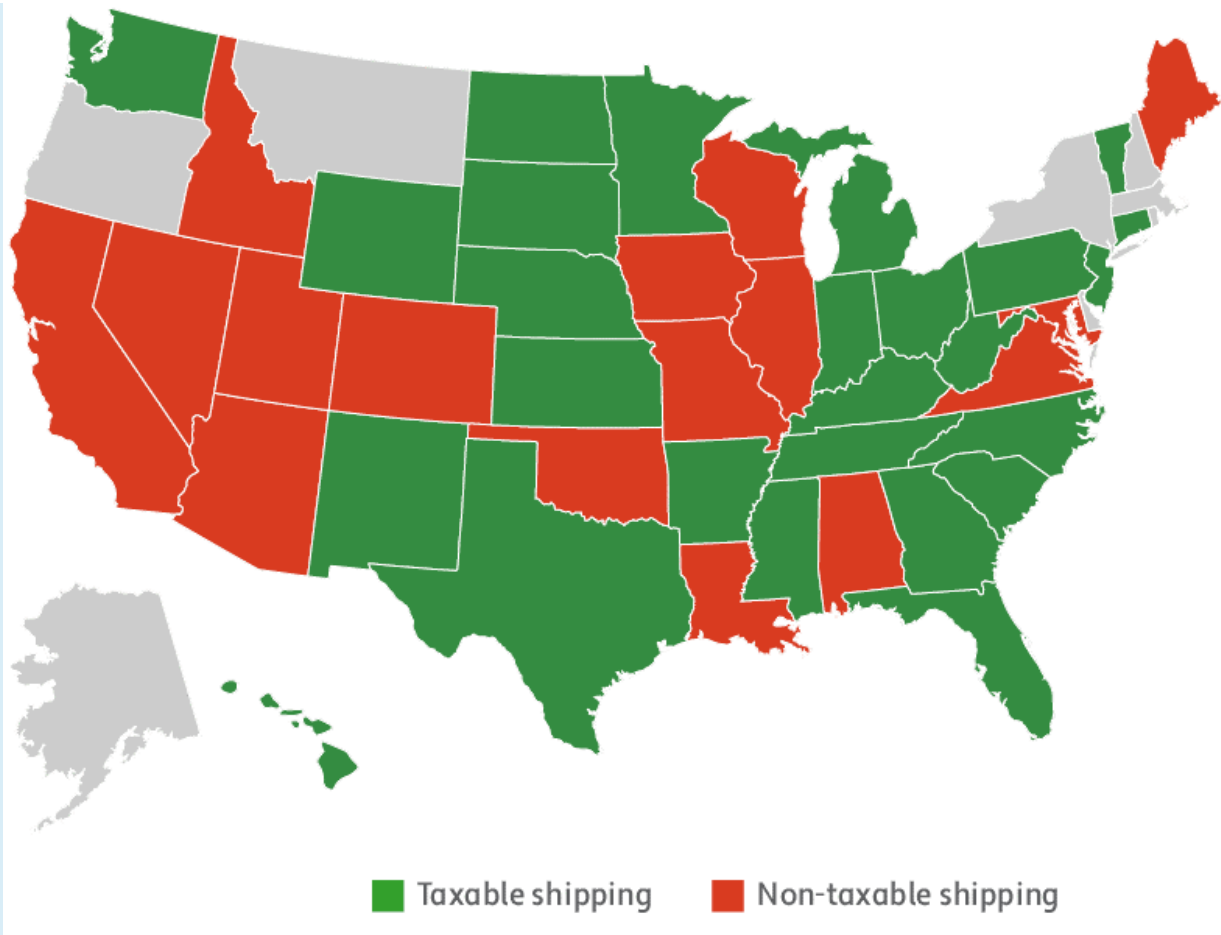
For sales within one state, most states charge sales tax on shipping and handling, as long as those costs are included in the order.

The following states usually consider charging shipping that is part of an order a taxable activity, regardless of whether sales tax is part of the price or not:

Arkansas, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Indiana, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Nebraska, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Vermont, Washington, West Virginia, Wyoming.

Conversely, the following states say shipping charges are not taxable if included in the price:

Alabama, Arizona, California, Colorado, Idaho, Illinois, Iowa, Louisiana, Maine Maryland (noted exceptions), Massachusetts, Missouri, Nevada, Oklahoma, Rhode Island, Utah, Virginia, Wisconsin. These two guidelines generally apply to online companies that sell within their own state. Out of state online sellers face a host of other complexities (discussed in #1).



3: Tax on freight typically follows the transaction.

If the goods you sell are exempt, the freight/delivery or handling charges are exempt. If taxable, the converse applies.

Freight is typically a nontaxable service, UNLESS it is considered a “necessary part of the sale.” In other words, it becomes taxable when you pay for the service and then charge your customer for it as part of the sale.

Freight or delivery is NOT taxable when the:

Customer pays the carrier directly. Freight charges are showed separately from handling. Freight is delivered using a common carrier like the postal service (versus the company's truck).

4: States often tax freight depending on the taxability of bundled items.

When taxable and nontaxable products are bundled into the same shipment, some states tax freight based on this ratio. For example: If a customer purchases a \$60 exempt item and a \$120 taxable item and both goods are bundled into one shipment, only the shipping costs associated with the \$120 item are taxable.

5: Ship-to-store models have unique taxability issues.

According to a recent UPS survey of customers, over 55% of respondents expressed a definite preference for buying online. And over 50% choose to have items shipped directly to the store. Many customers qualify for free shipping by utilizing ship-to-store services, and are shown to make additional purchases when in the brick-and-mortar location. Whether or not shipping in this case is taxable is under consideration in many states. For example, if the brick-and-mortar store is in one location and the online affiliate is located in another, but the customer takes delivery at a third location (or goes to the store to pick-up), the destination is typically the source of taxability rules. Except when it's not.

Conclusion

Sellers have a tough road to follow: managing shipping costs; increasing rates and reduction in services; fewer leverage points with shipping carriers; and increased scrutiny regarding sales tax.