

Sales and Use Tax for Life Science Companies: The High Cost of Getting It Wrong



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Chief Financial Officers want predictability when it comes to tax. Their goal is simple: pay the correct amount, optimize efficiency, and avoid unnecessary risk. What they do not want are surprises—especially those that come in the form of audits, penalties, or unexpected liabilities.

Achieving compliance, however, is becoming more difficult. Sales and use tax rules continue to evolve, and while many state laws look similar on the surface, subtle differences in how products and services are treated can create significant risk. This is especially true for life science companies with complex and innovative offerings.

Why Compliance Is So Challenging

Life science companies operate at the intersection of rapid innovation and outdated tax frameworks. As new therapies, devices, and service models emerge, state tax laws often lag behind, creating ambiguity in classification and treatment. Layer in relationships with contract research organizations (CROs), contract manufacturers, and third-party distributors, and compliance becomes even more complex.

The result is a fragmented and often inconsistent compliance landscape that requires careful, ongoing analysis.

The Real Cost of Non-Compliance

Failing to properly manage sales and use tax obligations can have significant financial and operational consequences, including:

- Paying sales tax out-of-pocket instead of collecting it from customers
- Exposure to audits, interest, and penalties
- Overpaying use tax on items that may qualify for exemptions
- Reputational damage associated with non-compliance

These outcomes are often the result of a reactive approach rather than a structured, proactive strategy.

Common Themes Across State Regulations

While each state has its own nuances, several consistent themes emerge that life science companies must consider.

Nexus: The Starting Point

Before determining whether to charge sales tax, companies must first evaluate whether they have established nexus in a state. Nexus creates a filing obligation and can arise from:

- Physical presence
- Economic activity, such as revenue or transaction thresholds
- Business relationships, including those with CROs and contract manufacturers

These third-party relationships can unintentionally create nexus, making this analysis more complex than it initially appears.

Prescription vs. Over-the-Counter Products

In many states, prescription drugs and certain medical devices are exempt from sales tax, while over-the-counter (OTC) products may be taxable. However, exceptions are common and vary by jurisdiction.

Assuming consistent treatment across states can lead to misclassification—especially for products that blur the line between pharmaceutical, device, service offerings.

R&D and Manufacturing Exemptions

Many states offer exemptions for research and development and manufacturing purchases. However, qualification requirements differ and often depend on proper documentation and exemption certificate management.

Failure to properly apply these exemptions can result in unnecessary tax expense or audit exposure.

Innovation Outpacing Regulation

One of the biggest challenges is the pace of innovation. Products that combine software, hardware, and therapeutic elements often do not fit neatly into existing tax categories.

This makes it critical for companies to evaluate new offerings proactively rather than rely on assumptions.

A Practical Approach to Compliance

Given the complexity, companies should adopt a structured approach to compliance.

1. Conduct and Maintain a Nexus Study

Start by identifying where your company has filing obligations. A comprehensive nexus study, performed by a qualified CPA firm, can provide clarity and should be updated regularly as your business evolves.

If gaps are identified, many states offer voluntary disclosure programs that allow companies to come into compliance while minimizing penalties.

2. Implement the Right Technology—And Optimize It

Sales and use tax software is essential for managing multi-state compliance. However, implementation alone is not enough.

Companies should ensure:

- Accurate taxability mapping for products and services

- Proper integration with ERP systems
- Ongoing maintenance as products and regulations change

If your current solution is underperforming, the issue may not be the software itself, but rather outdated configurations and/or inefficient processes.

3. Establish Strong Processes and Controls

Technology must be supported by well-defined internal processes, including:

- Defined ownership of tax responsibilities
- Documented workflows across tax, finance, and operations teams
- Regular reconciliations and variance analysis
- Review of tax calculations before filing

Many of these steps can be automated, reducing manual effort and minimizing risk.

How Dean Dorton Can Help

Dean Dorton brings together deep expertise in both the life sciences industry and sales and use tax automation consulting. This integrated approach allows us to help companies design, implement, and manage effective tax processes tailored to their specific operations.

Whether you are building a compliance framework or refining an existing one, our team can help ensure your approach is current, efficient, and aligned with evolving regulations—so there are no surprises.

Have questions or want to evaluate your current approach? [Get in touch with our team to start the conversation.](#)