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Compliance Audit Process Overview for Model 1 Sellers

This document sets out the requirements and issues to be addressed in conducting a compliance audit of Model 1 sellers.

Level of Transaction Documentation Required

A CSP shall maintain documentation and records sufficiently detailed so the Streamlined Sales Tax (SST) member states can easily ascertain the required information via an electronic download from the CSP. This documentation and records include the following:

- 1) For exempt products, a code that stipulates whether an exemption is based on the SST state's taxability matrix or other state statutes;
- 2) Separate codes that stipulate whether an exempt transaction is an entity, product or use-based exemption;
- 3) For each seller's customer, both the order and billing dates for each transaction;
- 4) The product description and code identification number for each sale;
- 5) A unique transaction number assigned to each sale;
- 6) For each seller's customer, the billing address and shipping location according to the applicable sourcing rules for each state;
- 7) In addition to the standard required information in (6) above, the customer name must appear on each exempted sales transaction;
- 8) For each seller's customer, the amount of sale for each product;
- 9) For each seller's customer, the tax rate and amount charged on each sale;
- 10) For each seller's customer, every jurisdiction receiving tax on each sale;

- 11) For any discounts applied, the taxable base should be easily discernable;
- 12) For invoices that include both taxable and exempt components, each item or bundled transaction must be clearly identified so that the tax calculation can be verified;
- 13) For each seller's customer, any tax reversal must be identified on each sale clarifying every tax jurisdiction credited;
- 14) A clear audit trail to substantiate credits (i.e., for returned merchandise, cancelled sales, etc.);
- 15) An electronic file that supports each tax return filed and recaps all tax collected for each seller from all sales within each jurisdiction; and
- 16) The prescribed uniform exemption certificates must be kept on file by the party responsible for the tax, either in electronic or paper format, to document all customers claiming exemption or exception from tax.

General Understandings Regarding the Audit Process

Ongoing communication is essential between CSPs and the SST member states during the period that a CSP is authorized to collect and remit tax. This dialogue should include clarification of any changes or other operational situations that have occurred that affect the compliance of the Model I sellers regarding the record keeping requirements stipulated by the Governing Board. Updates from the various states to their taxability matrix database must also be part of this frequent interaction through Testing Central.

State personnel within the Certification Committee will periodically conduct random tests of the CSP system via an online connection and perform regression tests to determine whether the correct tax rate is being applied according to the tax jurisdiction of the purchaser. Any discrepancies found as a result of these spot checks, regression tests or by other disclosures (such as customer complaints) shall be reported to Testing Central as outlined in Appendix E in Article V titled "*Testing Process for Certification of Service Provider*". Upon notification, the CSP must make corrections to its system within the required timeframe. The CSP shall remit tax to the SST states or refund any tax to purchasers affected by these discrepancies.

Procedural Audit Issues for a Model I Seller

SST member states will furnish personnel to comprise a core team of approximately four full-time SST auditors. This team will be responsible to coordinate any joint audit portions of every Model 1 compliance audit assignment. These auditors will report to the SST Audit Director for all audit assignments and procedural guidance. As part of its audit function, the core team would verify the following information:

- 1) Compliance with the terms of the CSP contract with the Governing Board;
- 2) That the compensation was calculated properly;
- 3) That all tax collected was remitted timely to the appropriate tax authority;
- 4) Federal tax returns from the seller match all sales reported by the seller on simplified electronic returns (SERs);
- 5) Acquire a list of all sellers represented by each CSP and provide this information to the appropriate SST member states.
- 6) Obtain a download of all sales per seller from each CSP and send each SST member state its portion;
- 7) Create a uniform audit plan with a timeline to establish the projected dates that various audit steps should be completed;
- 8) If an extension of the statute of limitations becomes necessary, waivers will be obtained based on the laws of each SST member state. The audit period may be extended to cover tax returns due in periods subsequent to the original audit period;
- 9) Compile all the audit results from the various states, summarize the findings and report them to the Governing Board. These summaries must comply with the confidentiality restrictions that apply to the Governing Board regarding disclosure.

SST States Conducting its Own Audits

Each state's designated SST auditor(s) will handle its state's portion of the joint audit and they will be responsible to ensure adherence to the audit plan and timeline. For these Model 1 audits, CSPs must provide a list of all sellers to the audit core team and the states will decide which

sellers to audit. Upon receiving and examining the electronic records sent to them from the audit core team, SST states would have the option to comprehensively review the records or choose sampling methodology to handle these SST audits. However, in the interest of uniformity, statistical sampling is the preferred methodology and should be utilized whenever it is deemed appropriate.

Some of the audit functions that the SST auditors would handle include verifying the following:

- 1) Each member state must review the seller's transactions and determine if they were taxed correctly. If errors exist, in order to ascertain if the resulting tax liability will involve an assessment for the past (instead of simply a correction that must be made prospectively), the auditors must determine if the errors were caused by any of the following reasons:
 - a) Deviation from the state's rates and boundaries tables;
 - b) Non-compliance with the state's taxability matrix;
 - c) If changes posted through Testing Central were not implemented in a timely manner;
 - d) If overrides (wherein the seller digressed from the CSP's system) prompted errors; and
 - e) If exemption certificates were not properly completed with all the required data elements or were not provided within the timeframe prescribed by the Governing Board. Rules for acceptance of exemption certificates are covered in Section 317 of the SSUTA and outlined in the "Issue Paper on the Simplified Exemption Administration Process".

If the audit findings indicate that there is an outstanding tax liability owed by a CSP, any resulting assessments must be generated by each individual SST Member State and follow the laws of each state regarding the appeal process and statute of limitations. However, prior to an assessment being issued, the CSP must be given an opportunity to review the audit results with the auditor(s) from each state wherein a tax liability exists. Prior to the issuance of any assessments, the Governing Board should be apprised by the Audit Director of any outstanding tax liability due from CSPs regarding any SST Member State. However, no assessments will be issued by the Governing Board.

Issues to be Addressed within a Tax Compliance Audit

When a compliance audit is conducted on a Model I seller, the following enumerates many of the issues that must be examined to ensure conformance with statutory requirements. Compliance audits may also affect the CSP evaluation process to determine if recertification should be granted based on adherence to tax compliance requirements:

- 1) Evaluate if the product classification mapping is correct by examining both the state's taxability matrix as well as the product based exemptions as cited in their laws. Mapping is the process by which products and services are classified to determine their taxability. The following two types of mapping must be defined and documented for review during a compliance audit.
 - a) The first type of mapping is "product-based classifications" which is based on "product-based exemptions" as provided in Section 502 and the taxability matrix as provided in Section 328 of the Streamlined Sales and Use Tax Agreement (SSUTA). This type of mapping identifies the taxability of products and services for each SST member state based on each state's laws. This mapping must be documented in the taxability rules of the CSP. This mapping must include all product and service exemptions as well as all taxable products and services that a state disclosed in the Taxability Matrix and the supplemental information required by Section 502 of the SSUTA.
 - b) The second type of mapping is the "product-coding" (i.e., SKU) which documents products and services belonging to a particular product-based classification (i.e., mapping a blouse to the product-based classification of "clothing").
- 2) The product-based classification system must clearly document all the changes that occur within the CSP system. The level of detail contained in these data downloads should include the following information:
 - a) A description of each product with its unique identifying number for each seller (i.e., SKU code);
 - b) The date that each product was coded into the system for tax application;
 - c) The product-based classification for each product;
 - d) The taxable status of each product including any changes to that status and the date the change occurred; and

- e) Verify that the CSP's change logs match the data recorded in Testing Central to document any and all changes made to the CSP system.
- 3) Reconcile if discounts reduced the tax base appropriately;
- 4) Determine if tax was credited for returned merchandise or cancelled sales; and
- 5) Verify tracking mechanisms are implemented to ensure that a clear audit trail exists.