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Implementation and Operational Requirements For a Simplified Exemption Administration Process (revised September 22, 2003)

One of the key uniformity and simplification features of the Streamlined Sales Tax System is a simplified exemption administration process. A number of provisions relating to a simplified exemption administration process are included in the Streamlined Sales and Use Tax Agreement approved by the Implementing States on November 12, 2002. The following sections of the Agreement pertain to a simplified exemption administration process:

204	Entity-Based Exemption
209	Product-Based Exemption
214	Use-Based Exemption
301	State Level Administration
304	Notice of State Tax Changes
312	Multiple Points of Use
313	Direct Mail Sourcing
316	Enactment of Exemptions
317	Administration of Exemptions
321	Confidentiality and Privacy Protections Under Model 1
326	Direct Pay Permits
327	Library of Definitions
328	Taxability Matrix
501	Certification of Service Providers and Automated Systems

There are four categories of issues that must be decided to implement and operationalize the provisions relating to a simplified exemption administration process included in the Agreement. They are:

Administrative issues:

- Information required on the exemption form
- Purchaser ID number
- Standard form
- Number of exemption forms needed (standard, MPU, direct pay)

Operational issues:

- Classification of exemptions

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- Do we need uniform exemptions for all exemptions
- Reason codes
- Blanket exemptions
- Renewal of exemptions

Systems-related issues:

- Effective dates for new product based exemptions
- Universal product coding system
- Valid exemption number databases

Audit issues:

- What is required for sellers to be relieved of good faith requirement?
- What is required for auditing exempt sales for Model 1 (Agent Model) sellers?
- What is required for auditing exempt sales for Model 2 (Tax Calc. by Agent) sellers?
- What is required for auditing exempt sales for Model 2 (Tax Calc. by Certified Software) sellers?
- What is required for auditing exempt sales for Model 3 (Proprietary Model) sellers?
- What is required for auditing exempt sales for Model 4 (Current Practices) sellers?
- What will be the record retention policy for exemption certificates?

The following recommendations to address these issues were approved by the government representatives in attendance at the September 2002 SSTP meeting:

Decisions made regarding administrative issues:

- Purchasers who claim exemption from tax will be required to provide their name, address, type of business, reason for exemption, ID number, state and country issuing ID number and signature (only required for paper form). **(see Appendix A)**
- States will not be allowed to customize the standard form.
- Each state will be able to choose whether or not to require an ID number.
- Acceptable ID numbers will be a state issued business or exemption number, federal ID number or driver's license. Social security numbers will not be requested.
- States will be encouraged to provide a state issued business or exemption number to any person eligible to claim an exemption.
- A standard paper form will be developed, however, substitute forms will be accepted if they contain the same information as the standard form. **(see Appendix B)**
- A standard electronic format will be developed but not prescribed to allow sellers the option of designing their own electronic form as long as the required information is obtained from the purchaser and retained.
- Only one exemption form is needed. Direct, MPU and direct mail are reasons for claiming exemption. Reason codes will be established for these purposes.
- States will be required to adopt the standard form for all exemptions.

Decisions made regarding operational issues:

- States will be required to classify their exemptions as product; use or entity based exemptions because each type of exemption will be handled differently in the Streamlined Sales Tax System.

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- The Project does not need to develop uniform definitions for all exemptions allowed by the states. We should strive to reduce the number of exemptions that must be defined by the Project.
- A high level (rather than a detailed) exemption reason coding system will be developed since sellers will be relieved of the good faith requirement. **(see Appendix C)**
- All sellers will be required to adopt the exemption reason coding system developed by the Project to assist states in verifying purchasers' eligibility for claiming exemptions.
- States will be required to accept blanket certificates.
- Blanket certificates will be allowed for all purposes.
- States will not be required to request renewal of blanket certificates.

Decisions made regarding systems-related issues:

- States will be required to follow the provisions of section 304 when enacting new product based exemptions since the product taxability matrix will need to be updated.
- A universal product coding system is not required for simplifying exemption administration since it would be too costly and time consuming to develop and keep current and would require all sellers to convert to such a system.
- Sellers or service providers will not be required to verify exemption numbers at the time of sale.
- States may require sellers or service providers to verify exemption numbers after the time of sale.
- Each state requiring sellers or service providers to verify exemption numbers against a state's exemption database will establish their own procedures for doing so.

Decisions made regarding audit issues:

- Sellers will be expected to collect the required information on an exempt sale at the time of purchase.
- Sellers will be expected to provide the required information on exempt sales when requested.
- Sellers will be relieved of the good faith requirement if the required information is obtained after the time of purchase if the exemption claimed is valid.
- Sellers will not be relieved of the good faith requirement if they allow exemption on a multiple-item invoice when only some of the items purchased qualify for exemption.

Revised Timeline for finalizing implementation and operational requirements:

September 2003

Decide outstanding issues relating to exemption administration
Approve business types, uniform reason coding system and exemption certificate
Approve Taxability Matrix form
Review exempt sales reporting requirements

November 2003

Review electronic format requirements for exemption certificate form
Approve exempt sales reporting requirements
Decide outstanding issues relative to the Taxability Matrix
Review action steps for states and sellers to comply with to meet requirements
Review audit procedures that will be performed to audit exempt sales

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Appendix A

Business Types For Simplified Exemption Administration and Processing

It has been decided that purchasers claiming exemption from tax on their purchases will need to provide certain identifying information, including “type of business.”

Ideally, we would want purchasers to provide their NAICS code to identify their type of business, but many purchasers will not know their NAICS code at the time of purchase. Requiring a purchaser to review a long list of NAICS codes to find the appropriate code for their business will slow down the order-taking process, prompt questions about the codes and could negatively impact on seller/purchaser relationships.

In lieu of providing a NAICS code to identify the type of business, it is recommended that purchasers select one of the following business types:

1. Accommodation and food services
2. Agricultural, forestry, fishing and hunting
3. Construction
4. Finance and insurance
5. Information, publishing and communications
6. Manufacturing
7. Mining
8. Real estate
9. Rental and leasing
10. Retail trade
11. Transportation and warehousing
12. Utilities
13. Wholesale trade
14. Business services
15. Professional services
16. Education and health-care services
17. Nonprofit organization
18. Government
19. Not a business
20. Other _____

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Appendix B

**Draft Streamlined Sales Tax Agreement
Certificate of Exemption**

See attached .pdf file

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Appendix C

Recommendation for The Streamlined Sales Tax Project's Exemption Reason Coding System

Decisions made:

- A high-level exemption reason coding system will be used
- All sellers and governing states will be required to adopt the exemption reason coding system
- The exemption reason coding system will facilitate multi-state joint auditing of exempt sales

Recommended Reason Coding System:

- A. Federal government
- B. State or local government
- C. Tribal government
- D. Foreign diplomat
- E. Charitable organization
- F. Religious or educational organization
- G. Resale
- H. Agricultural production
- I. Industrial production/manufacturing
- J. Direct pay permit
- K. Multiple points of use
- L. Direct mail
- M. Other _____

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Appendix D

Action Steps to Comply with the Requirements for the Simplified Exemption Administration Process

Governing States:

1. Classify exemptions and exclusions as product-based, use-based and entity-based using the definitions in the Uniform Sales and Use Tax Agreement
2. Complete the Taxability Matrix (three parts)
 - Treatment of uniform definitions in the Library of Definitions
 - Identify and define product-based definitions not listed in the Library of Definitions
 - Identify and define taxable services
3. Decide if an ID number will be required for purchasers to claim exemption from tax on purchases sourced to the state
4. Decide if sellers will be required to verify the validity of ID numbers
5. If a state decides sellers will be required to verify ID numbers, the state will establish procedures for doing so after the time of sale
6. Adopt the uniform exemption certificate form for all exemptions. Governing States can not modify or customize the uniform Exemption Certificate form
7. Eliminate the use of other exemption forms
8. Allow sellers sufficient time to update their exemption certificate files and to begin accepting the new uniform exemption certificate form

Sellers:

1. Code taxability of products/services offered for sale using the Taxability Matrix (The default rule used to code the taxability of tangible personal property, digital property and services differs when the taxability of the item being sold is not clear. **See Appendix E**)
2. Update exemption certificate files to obtain new exemption certificates from purchasers.
3. Review and revise seller's customized exemption certificate to ensure all required fields of information are requested
4. Ensure seller's internal procedures are effective so mandatory fields of information are collected at the time of sale when a purchaser claims exemption on a sale

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Appendix E

Default Rules For Coding the Taxability of Products

Tangible Personal Property:

- Taxable unless specifically exempted or excluded

Digital Property:

- Exempt unless specifically taxed

Services:

- Exempt unless specifically taxed for states that enumerate taxable services
- Taxable unless specifically exempted for states that tax all services except those specifically exempted