Avalara CertCapture



THE ULTIMATE GUIDE TO

Exemption Certificates for Sales Tax Compliance

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To learn how Avalara CertCapture can help streamline and simplify the exemption certificate management process, visit certcapture.avalara.com or call 844.418.500



Introduction

Achieving sales tax compliance in today's complex environment is no easy feat. There are changing rates to calculate, evolving requirements to monitor and a wide array of exemption certificates to manage. Companies must handle every step correctly, and each one is riddled with potential pitfalls.

One of the most problematic parts of the compliance process is properly collecting, validating and storing exemption certificates. This highly valuable tax compliance documentation is the proof you need to support non-taxed sales. These certificates can be the difference between a costly assessment and a smooth, seamless audit.

Unfortunately, properly documenting exemption and resale certificates can become incredibly complex when numerous states, entities and variables like nexus and drop shipments come into play—not to mention the challenges of properly storing certificates if your business still relies on paper-based filing systems. Thorough and accurate exemption certificate management requires input from various departments; tax analysts, credit managers and IT departments all play important roles in the process.

To achieve and maintain sales compliance, it's critically important to understand how exemption certificates work, when to collect them and what steps to take so they remain valid and up to date.

In this guide, you will learn how to:

- ✓ Identify the correct certificates for various states and entities
- ✓ Determine which exemption certificates to use in different transactions
- ✓ Solicit the correct certificates in a timely and customer-friendly way
- ✓ Automate manual and paper-based processes to streamline certificate management
- ✓ Integrate exemptions certificates with other software and solutions



The Exemption Certificate Challenge

Before establishing a new exemption certificate management process, it's important to be aware of potential pitfalls. Countless businesses spanning numerous industries stand to be impacted by improper management of exemption certificates this year: retail stores, eCommerce sites, manufacturers, wholesale distributors, fuel suppliers...and the list goes on.

Many of these organizations think they're fully documented, organized and adequately prepared for a sales and use tax audit. Often, it's not until the audit notice arrives that a company will realize it should have had a better process in place to safeguard against invalid or missing exemption certificates that increase liability.

The first and most common cause of this pain is the method of storage: While virtually no business still relies on pencils and calculators to manually calculate or file taxes, the same is not true of the tools used to manage compliance documentation. Many companies still use filing cabinets, palletized boxes and off-site storage to manage hard copy documents in systems that make it difficult to produce valid customer exemption certificates on demand during an audit.

Meanwhile, credit managers and sales associates face the stress of customer service issues when valid exemptions or fillable certificates can't be produced in a timely and efficient manner. They may be forced to get numerous employees involved in validating an exemption status at the point of sale, or they might be tempted to let the lack of a valid certificate slide in favor of a verbal agreement that one will be provided after the tax-free transaction is completed.

Lastly, there are the challenges inherent to homegrown automation solutions. Unless an IT team has both the capacity and specialized skillset to continually code integrations as your business grows, automating the process in-house can be an arduous and costly undertaking.

Waiting until an audit notice arrives to correct these problems is bound to ensure compliance issues. The sooner you begin to streamline and simplify the exemption certificate management process, the lower your audit exposure will be. As an added benefit, many companies find that exemption certificate efficiencies also lead to decreases in customer service issues and increases in loyalty.



While many companies recognize the need for an efficient exemption certificate management process, nearly half (48%) of accounting professionals in the U.S. believe an auditor would likely find mistakes like missing or incorrect compliance documents in the event of an audit.

Source:
Wakefield Research Report

The Basics of Sales Tax Exemptions

When is a sale tax exempt in the U.S.? Generally speaking, there are three main scenarios where a transaction can take place without sales tax having to be collected:

The buyer is tax exempt by law.

Examples could include government agencies, schools, nonprofit charities and hospitals.

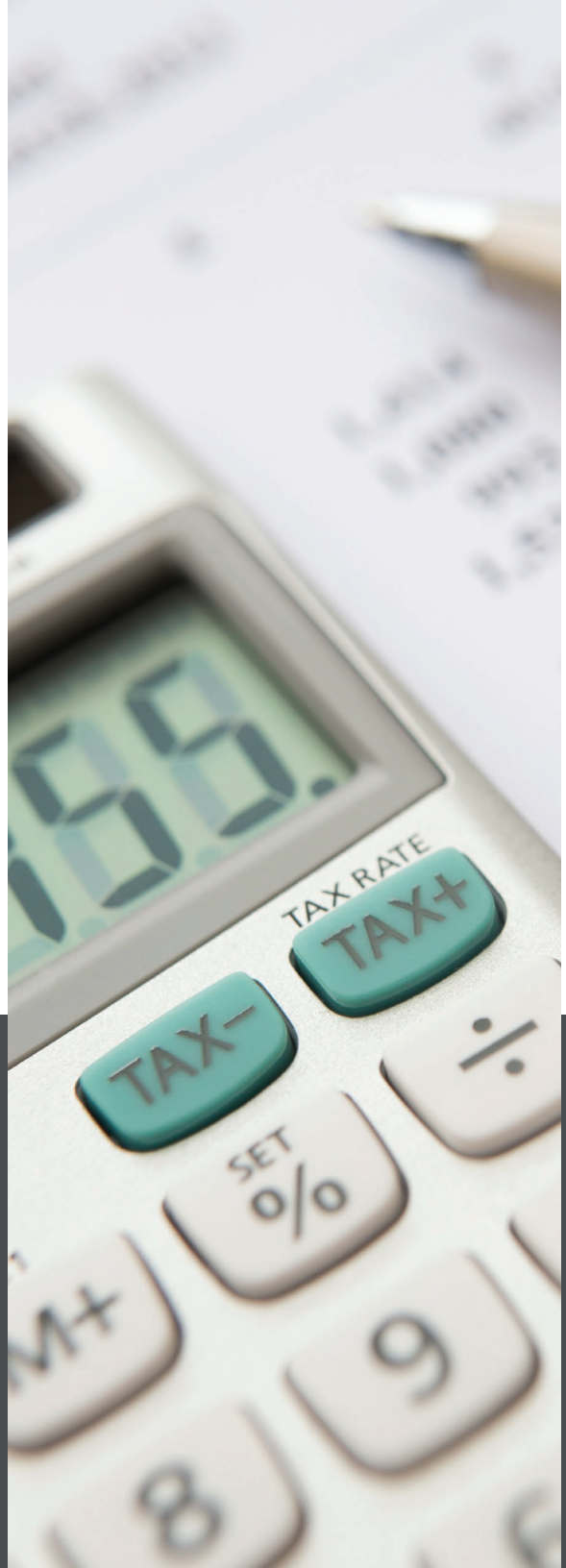
The type of transaction is tax exempt.

The buyer is using the goods in a manner that is exempt, such as reselling or incorporating it into another product. These transactions are exempt when properly documented by an exemption certificate.

The product itself is non-taxable.

This is often the case with certain types of food, medicine and services.

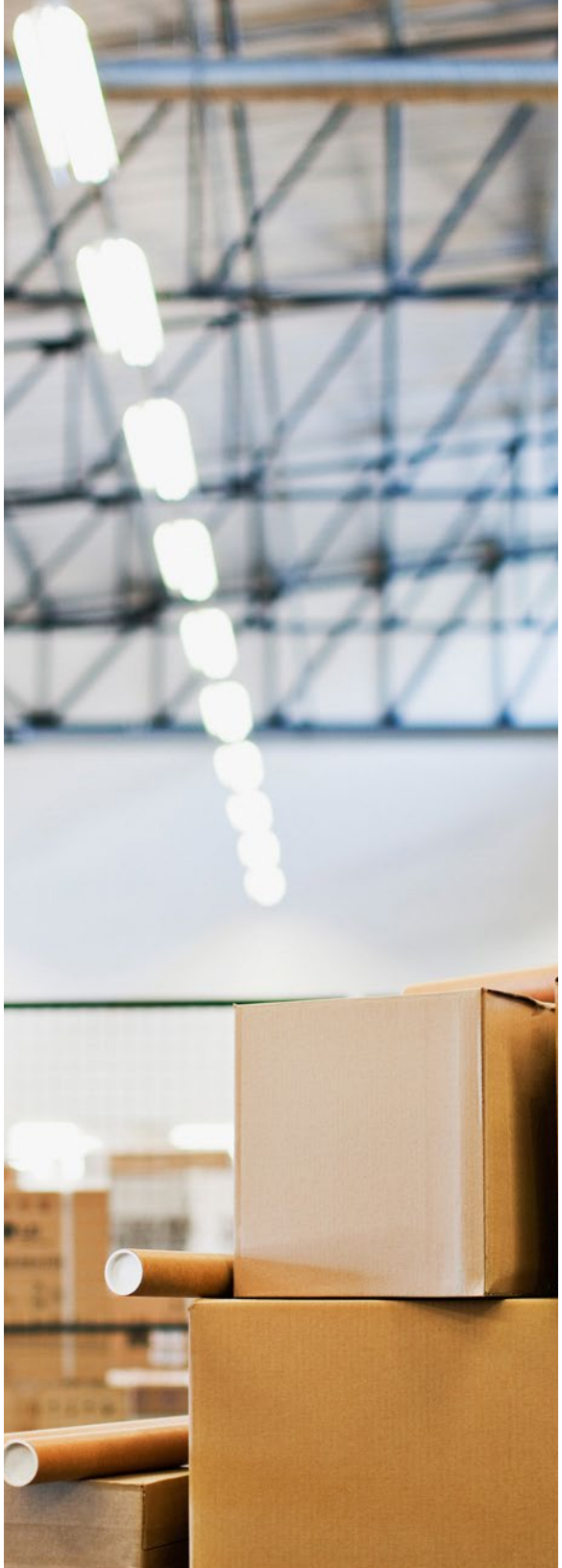
Each state has its own set of rules on how to handle tax exemptions in each of these categories. Achieving compliance requires identifying the correct certificates—a task that is ultimately the responsibility of the seller. If a valid certificate cannot be produced, the purchase should be taxed or the seller will risk becoming liable for uncollected taxes in the event of an audit.



Did you know?

The average cost of an audit is more than $114,000.

Source:
Wakefield Research Report



When Exemptions Get Complicated

Many companies, particularly ones that deal with eCommerce and resale, face two common hurdles to overcome when transactions take place in more than one state:

Nexus

When tax-exempt sales span multiple states, the exemption certificate process is impacted by nexus. While each state takes its own approach to this term, nexus is generally defined as a "presence" in a state that's significant enough to require a business to comply with the state's sales tax laws. Common measurements for gauging physical presence include employees, property ownership and leases. For some states, nexus is established when a business advertises or solicits business in the state. In others, using company vehicles to deliver goods establishes nexus.

For example, consider a brick-and-mortar floral retailer with several stores located in Cincinnati, Ohio. The presence in Ohio means the company has nexus—an obligation to collect taxes—and must be registered in the state. But what happens when the florist makes the arrangements it produces in Ohio available for delivery across state lines to Kentucky and Indiana? If it begins to ship flowers to customers in Florida, will it have nexus in Florida? The answers to these questions will vary from state to state and may even change as states and courts redefine how nexus is determined. To remain compliant, it's important to become familiar with different state rules and understand which exemption certificates are required for tax exempt sales in states where your company may have nexus.

Drop Shipments

Sometimes, a seller will accept an order for a product it doesn't actually carry. To get it to the customer, the seller places an order with a third party supplier—perhaps a wholesale warehouse or manufacturer—and directs that company to deliver the goods on its behalf.

If this sounds familiar, your company is in a drop shipment relationship. Exemption certificates are very common in drop shipments because they typically involve resales. However, the rules around what determines nexus in drop shipment scenarios and what qualifies as an exemption can vary greatly from state to state. It's critically important to become familiar with these requirements and decide what types of exemption certificates you will accept.

Best Practices for Managing Exemption Certificates

Proper management of exemption certificates involves several steps. Each one must be handled thoroughly and efficiently.

Soliciting and Capturing

Any time a client or customer claims a sales tax exemption—whether it's a government agency purchasing products in bulk or a retailer purchasing items for resale—a valid, up-to-date exemption certificate must be produced. The reason for this is simple: A company could be 95% compliant, but if an auditor reviews a sample set and identifies records for the 5% of accounts with incomplete or expired certificates, the business could become liable for the projected tax liability of 100% of the population of sales. This could translate into an amount much higher than just the uncollected taxes. Although it's possible to follow up months or years after a transaction, this approach becomes problematic when the customer has gone out of business, changed its name or is otherwise impossible to contact.

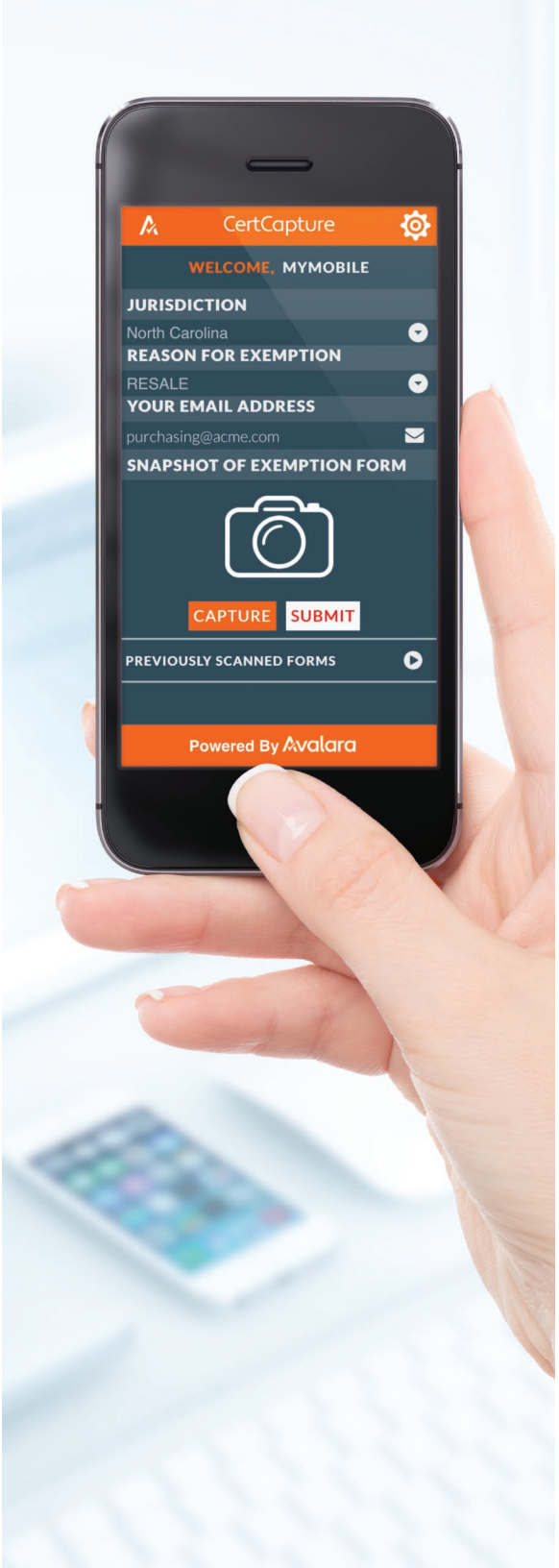
Best Practices for Solicitation and Collection

You can stay ahead of these challenges by implementing several best practices:

Stay updated. If you do business in multiple jurisdictions or are in a drop shipment relationship, determine where your business has nexus. Review every possible scenario and, if necessary, call upon a specialist who is up to date on the latest state exemption certificate requirements.

Be thorough. Identify every state exemption certificate your company will need for each type of transaction. This will make it easier to identify the correct compliance document at the point of sale. A good place to start is Avalara CertCapture's free exemption certificate library.

Make it convenient. Develop a system that gives salespeople and credit managers easy access to blank, fillable certificates for use when onboarding new customers. In addition, ensure they can quickly verify exempt statuses of existing customers at the point of sale.



Validating and Tracking

As your company collects exemption certificates, it's important to take a good, hard look at each one and ensure it contains all the information that will be needed in an audit. Often, all it takes is one small oversight—an overlooked field, a forgotten signature—to incur penalties. Expiration dates are another consideration. Exemption certificates have different expiration dates in different jurisdictions; some could be valid in perpetuity and other certificates will need to be renewed before they expire or, at the very least, before a new exempt transaction takes place.

Best Practices for Validation and Tracking

Avoid surprises during an audit by following these best practices:

Inventory regularly. Have a formal system in place to identify and flag incomplete certificates. Then follow up with customers in a timely, efficient manner so they can complete their records in the event a certificate is missing information.

Record expiration dates. How long a certificate will remain valid depends on the jurisdiction, so you must track these dates and plan accordingly. In many states, certificates need to be renewed every five years. In others, it's three. And there are some states where certain certificates never expire.

Stay ahead of deadlines. To avoid confusion in the event of an audit, have a follow-up plan in place. Providing customers with ample time to update or submit new certificates can greatly reduce risk in the event of an audit.

Did you know?

CertCapture tracks all of this automatically for you.



Storing and Systemizing

To be adequately prepared for the tax exempt portion of a sales tax audit, your company will need to know several things ahead of time: what percentage of sales are tax exempt, how many exemption certificates are on file, which ones have expired and how many are missing information or need to be updated. Having a solution in place to properly store and index certificates will not only make it easier to extract information requested by an auditor, but also ensure your company is aware of any potential liabilities well in advance. Equally important is the ability to quickly locate, verify and store certificates at the point of sale.

Best Practices for Storage and Systemization

Further reduce your audit risk with these best practices for managing exemption certificates:

Index: Ensure all of the exemption certificates you've collected are easily searchable and accessible. Since it's impossible to predict which certificates an auditor will request, being able to instantly comb through all of your records and extract the right ones is crucial.

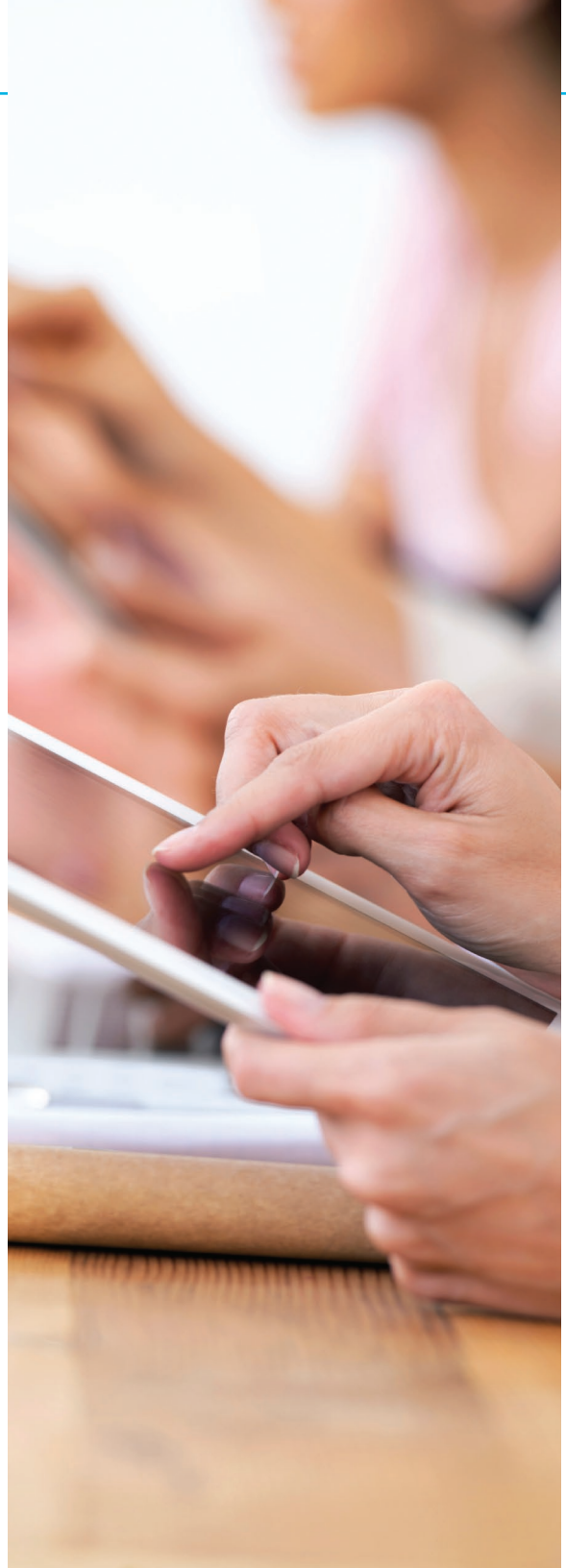
Integrate. Seamless integrations between your exemption certificate process and other solutions will reduce the amount of time spent matching customer accounts to compliance documents and exemption statuses. Ideally, exemption certificates should be integrated with any tax determination, point of sale, customer relationship management (CRM) and enterprise resource planning (ERP) software your company uses.

Automate. Unless your company handles only a handful of certificates each year, automating the exemption certificate management process will help eliminate manual errors. Automation also reduces the amount of time and money it takes to manage audits.

Krispy Kreme Doughnuts, Inc. decreased their audit liability by over 90% using CertCapture.

Vida Reese
Tax Analyst, Krispy Kreme Doughnuts, Inc.

TechValidate
TVID: CAE-B50-5D5



Automating Exemption Certificate Management

Manually implementing the above steps may suffice at a company that handles a few tax-exempt transactions each year. However, businesses that deal with multiple jurisdictions and certificates can be at risk when traditional paper filing processes become riddled with errors and require a lot of time and energy to maintain. Companies that rely on IT departments for coding and integrating in-house systems must stay ahead of security threats that can compromise customer and company data.

For these reasons, many companies are choosing to automate solicitation, collection and storage of exemption certificates—and even outsource the entire management of these processes to exemption certificate specialists. When manual, paper-based and homegrown systems are replaced by automated solutions:

- Exemption statuses are instantly matched to customer accounts
- Fillable certificates are available at the point of sale
- Expiration dates are tracked automatically and renewal requests are sent before certificates expire
- Customers can complete certificates in secure web portals and mobile apps
- Auditors can be given access through special audit portals



Conclusion

In summary, to correctly collect, store, validate and manage exemption certificates for sales tax compliance, you must:

- Understand where your business has nexus
- Stay updated on rules and exemption certificate requirements in each state
- Make it easy for customers to submit certificates during transactions
- Empower employees to quickly verify an exemption status at the point of sale
- Regularly inventory for missing or incomplete certificates
- Stay ahead of expiration dates

This process can be very overwhelming for many retailers, suppliers and distributors— especially ones that work in numerous states or handle a lot of drop shipments. Avalara CertCapture is designed to handle the entire process from start to finish.

More than 2,000 customers trust Avalara CertCapture to securely manage 17 million compliance documents. By fully automating a traditionally inefficient and paper-heavy process, Avalara empowers companies to simplify and streamline the entire exemption certificate management process.

Rest Easy with Avalara CertCapture

Avalara CertCapture can integrate with hundreds of customer management systems, retail and eCommerce transaction systems and tax calculation engines, enabling organizations to provide compliance information at the point of sale – or wherever it is needed – to deliver a better customer experience while reducing risks.

Be Audit Ready and Reduce Risks

- Access compliance documentation quickly and easily and respond to audit requests in seconds
- Stay current with new tax laws and regulations with automatic updates
- Track upcoming renewals, expirations and missing documents with automatic updates
- Maintain a secure digital library of documents with nearly unlimited data fields and attributes for effective reporting and analysis

Optimize Time, Resources and Investments

- Automatically distribute personalized letters, emails and faxes to request new customer forms, and collect completed forms through scans, faxes, emails or a secure online portal
- Convert paper documents into digital documents at the time of transaction with a new, easy-to-use mobile app
- Add new forms and documents quickly and easily, scaling to meet new business needs
- Deploy and support new client instances quickly and easily
- Maximize existing technology investments by integrating with hundreds of customer management systems and tax calculation engines through industry standard file and API methods

Delight Customers

Use simple add-ons for point of transaction systems both in-store and online to ensure compliance information is available where needed to improve customer experience

> “We no longer have to wait for each store to send in paper certs. Information is entered in real-time and available immediately, putting us back in control of the process instead of waiting for information to filter in. With data immediately available, I can pull 300-400 certificates in four hours or less—that’s down from months of work. CertCapture has made the audit process tremendously easier and far less painful.”

Greg Moosbrugger
Tax Analyst, Northern Tool + Equipment

About Avalara Compliance Document Management

Avalara helps organizations reduce audit risks and increase compliance by providing an easy-to-use, cloud-based solution that manages a comprehensive range of tax-related compliance documents, including sales tax exemption certificates, federal withholding forms and excise business licenses.

Avalara CertCapture

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