

The Sales Tax Exemption Certificate Audit Handbook





Avalara

To learn how Avalara can help streamline and simplify the exemption certificate management process, visit www.avalara.com or call 877.780.4848

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Introduction

Most companies aren't just at risk of being audited. Many are far less prepared for such an event than anyone at the organization realizes. As state audits become more frequent and auditors are less lenient than they may have been in years past, all those documents you spent so much time collecting and storing may not have the complete and correct information necessary to prove compliance under audit .

Too often, sales and use tax audits don't go as expected simply because one critical sales tax exemption certificate preparation step was overlooked. This handbook will guide you through each step and help you more thoroughly prepare for your next exemption certificate audit.



5 Signs It's Time to Better Prepare for a Sales Tax Exemption Certificate Audit

Why are so few companies prepared for an exemption certificate audit? The answer is simple: Most have no idea what their liability would be. Rather than proactively preparing for the possibility of an audit, many organizations wait to spring into action until after the audit notification letter arrives. This reactive approach means it could cost the average company more than \$114,000* per audit.

If one or more of the following statements apply to your organization, it may be an indication that it's time to restructure your sales tax exemption certificate management process:

1. You have lost track of the precise number of exemption certificates your company has stored.
2. You do not know what percentage of exemption certificates are missing information.
3. You do not know what percentage of exemption certificates will expire within the next month.
4. Your staff spends a lot of time manually emailing, sending letters, faxing or making calls to update expired or invalid exemption certificates.
5. Collecting a new certificate or verifying a customer's exemption status at the point of sale is often a time-consuming process that requires multiple employees.

On the following pages, we will walk you through proven methods you can use to prepare for (and weather) an exemption certificate audit with confidence.

*Source: 2015 Wakefield Research Report: The Executive's Guide to Sales Tax Risk

Real-Life Audit Nightmares

If you're wondering what the implications of missing and expired certificates look like, consider these case studies from Mike Fleming, Director at Peisner Johnson & Company.

After being audited by the state, the Texas subsidiary of a national company was handed a \$4 million assessment—and half of that assessment was related to missing or invalid exemption certificates.

A few states over in New Jersey, a manufacturing company faced nightmares when the accounting department's plan for collecting exemption certificates wasn't followed through on the ground at its various plants. Employees were collecting certificates on taxable jobs, but not on tax exempt jobs (until years later) and their invoices were being short-paid.

If you don't know how many certificates you have on file, haven't stored them digitally or aren't aware of how many are missing, it's very likely that a lack of organizational procedures are to blame. Or future issues might stem from simply having far more invalid and expired certificates than anyone at the company realizes.



Evaluate your current process

A few preliminary steps will give you a better understanding of exemption certificate requirements in your state and make it easier to fine-tune your current process.

Step 1. Make sure employees know when to collect certificates

Is your company collecting certificates from the right customers at the right times? Do your credit departments and salespeople know which forms to provide when customers claim they're exempt? Are certificates properly integrated with your website for online sales? If not, find out what procedures your colleagues are currently following so you can identify ways to make it easier to collect valid certificates.

Step 2. Ensure employees are collecting the correct certificates

Anyone can verbally claim they're exempt from paying sales tax, but if you don't have accurate and up-to-date documentation to support those claims, your company will be liable for unpaid taxes in the event of an audit. Moving forward, you can prevent this by staying up-to-date on the laws governing collection of exemption certificates in each state where your company has nexus. Once you understand which certificates need to be collected for each jurisdiction, you can begin providing blank, fillable copies of the correct exemption certificates at the point of sale.

Step 3. Inventory existing certificates

Over time, paper-filled metal filing cabinets and digital storage folders can overflow, mixing new certificates with outdated ones. This can make it difficult to locate the documents you need for an auditor. For this reason, it's important to keep a real time inventory on how many exemption certificates you have and how much they're worth.

EVALUATION WORKSHEET

What is your company doing today?

How are certificates currently being collected?

By credit managers: _____

By sales team: _____

In person: _____

Online: _____

Other: _____

On a scale of 1 (audit scared) to 10 (audit ready), how confident are you in your current exemption certificate collection process?

1	2	3	4	5	6	7	8	9	10
☹️							😊		

If you are in the 1 to 7 range, how will you prepare?

- Schedule to meet with _____
- Document detailed instructions for _____
- Write scripts employees can use when interacting with customers
- Improve our collection of available blank, fillable exemption certificates

Conduct your own internal audit

When was the last time you took a good, hard look at your existing collection of certificates? Even if you have a piece of paper, it may not be exactly what you'll need during an audit.

Step 4. Catalogue current certificates

How many of your certificates are up-to-date and fully verified? If you're lucky, this will be the biggest pile or fattest folder. If not, you'll need to set aside more time for the next several steps.

Step 5. Inventory the incompletes

How many certificates are missing data? Often, all it takes is one small oversight—an overlooked field, a forgotten signature—to incur hefty fines in an audit. Keep any incomplete records in a separate pile or folder for easy access as you organize. You'll need to follow up with these customers to complete their records.

Step 6. Record expiration dates

How many certificates are expiring this month? Next month? Next quarter? How long a customer's certificate remains valid will depend on your jurisdiction. In many states, they need to be renewed every five years. In others, it's three. And there are some states where certain certificates never expire.

To avoid confusion in the event of an audit, you'll need to track all those dates and have a plan in place for following up with your customers. Staying ahead of deadlines and providing customers with ample time to submit new certificates will reduce your risk of missing certificates in the event of an audit.

With the sampling technique used by sales and use tax auditors, just one missing or invalid document could result in thousands of dollars in fees and fines. For this reason, it's crucial to be aware of your current state of certificates before an auditor walks through the door.

For each customer, ask yourself important questions such as:

- Do we have the right certificate?
- Did we collect the correct tax amount?
- Is the certificate thorough and accurate?

Any time the answer is “no,” it's time to proactively prepare your records by getting a customer to update the incomplete or expired certificate. Whether you automate the process or rely on papers and PDFs, the goal is to continually be working toward 100% compliance.

INTERNAL AUDIT WORKSHEET

Total number of certificates: _____

Number of valid certificates: _____

Number of incomplete certificates: _____

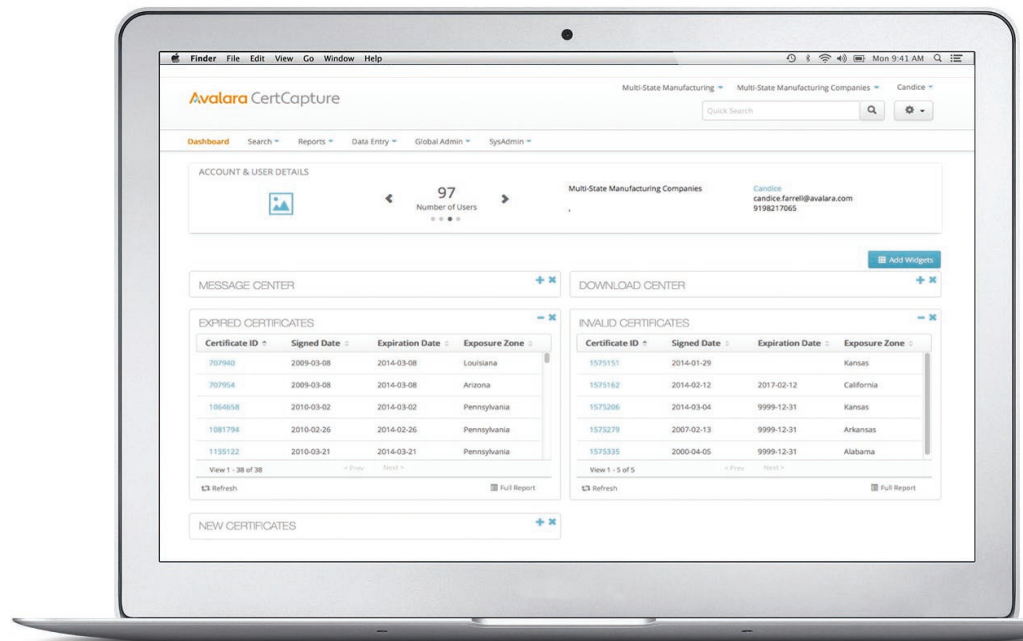
Number of missing certificates: _____

Which certificates will expire and need to be renewed?

State	Certificate	# Years Valid	Request Next Renewal By
Issuing state	Certificate ID	3, 5, etc	Month/Year

Did you know?

Avalara has a customizable dashboard that enables you to see missing, invalid or expiring certificates.



Make a plan

If those first six steps sound like a lot of work, it's because they are. But get a good system in place today and you'll spend far less time weeding through files and folders in the future.

Step 7. Follow up

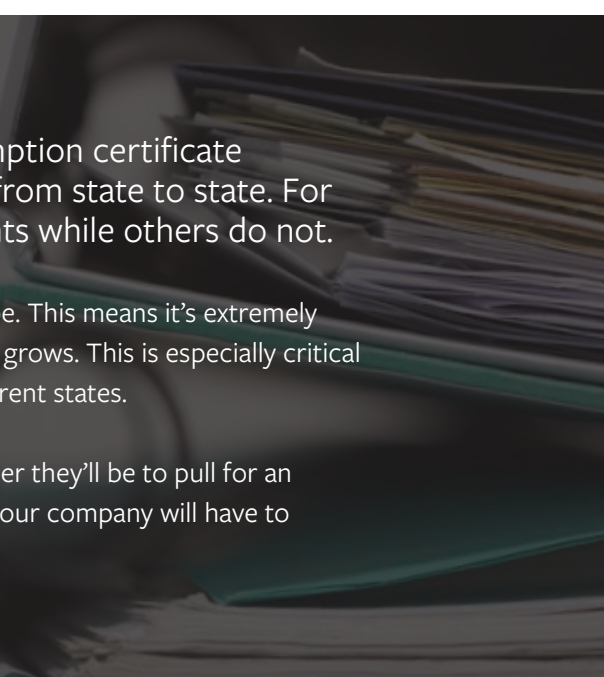
Unless you want to devote weekly work hours to following up with customers, you'll need templates, alerts, automated emails and more. If your business works with a small number of tax exempt customers, some simple spreadsheets and business software may suffice. But if you work with dozens or hundreds of tax-exempt customers, you can save a lot of time and money with an all-in-one tool designed to handle these tasks.

Step 8. Systematize your collections process

As you catalogue, categorize and correct your current collection of exemption certificates, ensure they're all easily searchable and accessible. Since you don't know which certificates an auditor will request, you'll need a system that lets you quickly search through all your records at once to extract the right ones.

Step 9. Plan ahead

As you work through each step, decide how you will update and maintain records in the future. The more you can automate, the easier it will become over time!



Like most sales tax issues, the steps to achieving exemption certificate compliance aren't always clear cut and can vary a lot from state to state. For example, some states have yearly renewal requirements while others do not.

The bigger your business, the more vigilant your auditor is likely to be. This means it's extremely important to stay up-to-date on the latest tax laws as your company grows. This is especially critical if your company sells multiple products and services into many different states.

The more you know about the accuracy of your certificates, the easier they'll be to pull for an auditor. And the more helpful you can be, the less time and money your company will have to spend during the audit itself.

PLANNING WORKSHEET

How will you follow up with customers whose certificates are missing, incomplete or expiring soon?

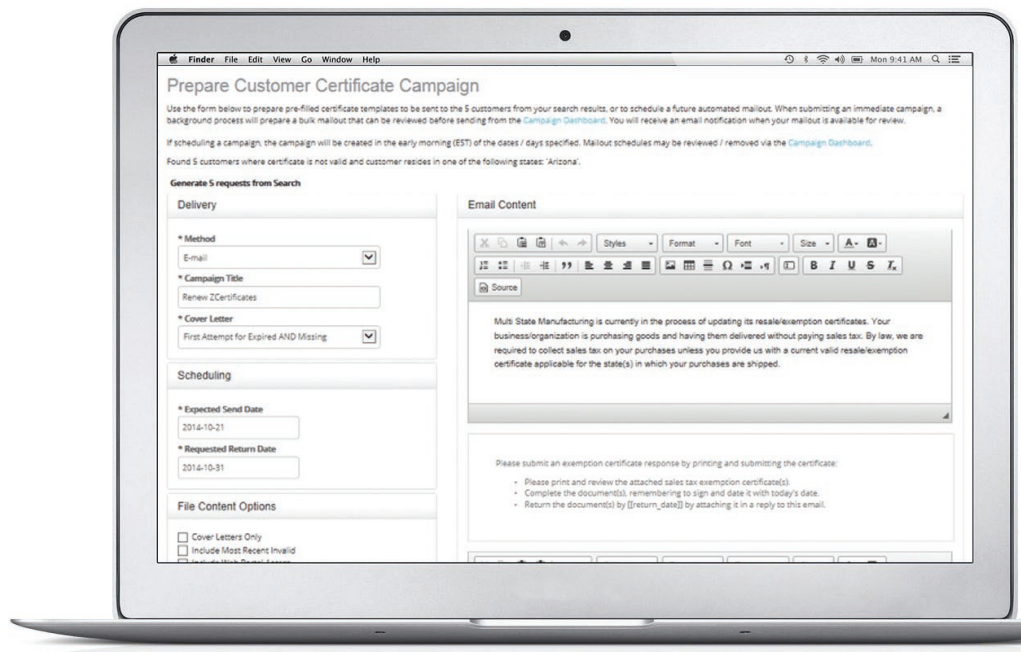
- Automated email
- Manual email
- Mailed letter
- Phone

Which department or employee will be responsible for following up with customers whose certificates are missing information?

Which department or employee will be responsible for following up with customers who were exempted from sales tax but have not yet supplied a valid exemption certificate?

Did you know?

Avalara has letter and email templates you can use for incomplete, expiring and missing certificates.



Tips to Reduce Audit Liability



Stay up-to-date

Make sure your team is regularly reading up on the latest changes to relevant tax laws. This is especially important if you're not using automation software or services.



Use the correct forms

Use Avalara's free [exemption certificate library](#) to quickly identify and download the correct certificates for any U.S. state and the District of Columbia.



Ensure certificates are current

Don't wait too long to update inaccurate, incomplete or expiring certificates. While many auditors will offer a grace period, you're out of luck if a customer has ceased operations.



Enable customers to submit certificates

To prevent having to unnecessarily track down missing certificates later, make it easy for customers to provide exemption certificates at the point of transaction, whether it's through a manual system or mobile app (or another solution in between the two).



In-store and Online Shopping

Give customers a seamless experience by providing the same options in-store and online. This is especially important for eCommerce companies: If customers are unable to provide certificates while making purchases online, they may go to another eCommerce site where tax-exempt purchases can be completed.



Track expiration dates by state

If you're not using automation software, create your own state-by-state matrix of expiration dates to ensure you are providing customers with ample time to submit new certificates. By staying on top of expiration dates, you can reduce your liability for uncollected sales tax and show your auditor that you've made a good faith effort to play by the rules.





Conclusion

Sales tax compliance is a complex business, but it is possible to achieve without losing your mind. Take it one step at a time to avoid being overwhelmed and, most importantly, develop a system that will be easy to maintain in the long run. A proactive process for collecting, validating and managing exemption certificates today can save your company from significant headaches tomorrow.

Rest Easy with Avalara

If you are feeling overwhelmed by the volume of exemption certificates under your purview, Avalara can help. By fully automating a traditionally inefficient and paper-heavy process, Avalara empowers companies to simplify and streamline the entire exemption certificate management process.

In fact, more than 2,000 customers trust Avalara to securely manage 17 million exemption certificates and other compliance documents.

Avalara can integrate with hundreds of customer management relationship systems (CRM), retail and eCommerce point of sale systems and tax calculation engines. These integrations enable organizations to provide compliance information at the point of transaction—or wherever it is needed—to deliver a better customer experience while reducing risks. Here are a few of the things you can achieve with Avalara:

Be Audit Ready and Reduce Risks

- ✓ Stay current with new tax laws and regulations with automatic updates
- ✓ Track upcoming renewals, expirations and missing documents with automatic updates
- ✓ Access compliance documentation easily and respond to audit requests in seconds
- ✓ 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 an easy-to-use mobile app
- ✓ Maximize existing technology investments by integrating with hundreds of enterprise resource planning (ERP) and tax calculation engines through industry standard file and API methods

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SNAPSHOT OF EXEMPTION FORM



CAPTURE

SUBMIT

PREVIOUSLY SCANNED FORMS



Powered By  Avalara

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.



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