



## Exemption Certificate Management and Audit Study

August 7, 2007



### Research Background

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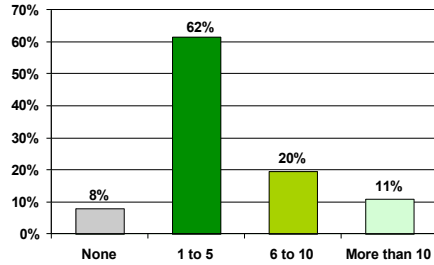
- ▼ **Vertex was looking to gain insight into government and taxpayers costs associated with exemption certificate management.**
  
- ▼ **Two research studies conducted in summer 2005:**
  - Corporate Tax Professionals
  - Department of Revenue sales and use tax audit officials



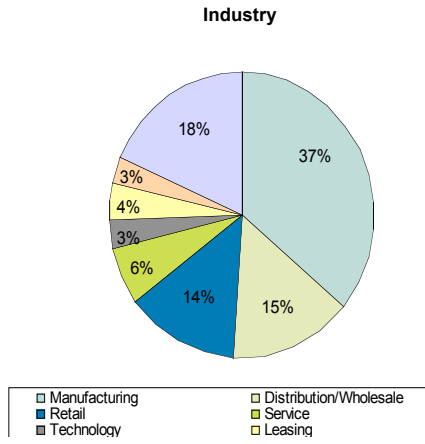
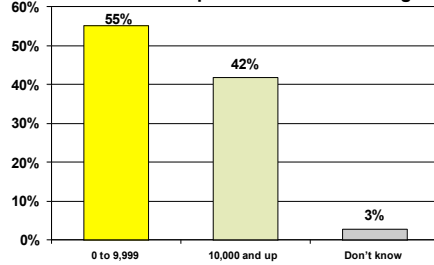
### Characteristics of Companies: Audits, # Certs. and Industry

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Number of audits conducted in the last 12 months



Number of exemption certificates managed

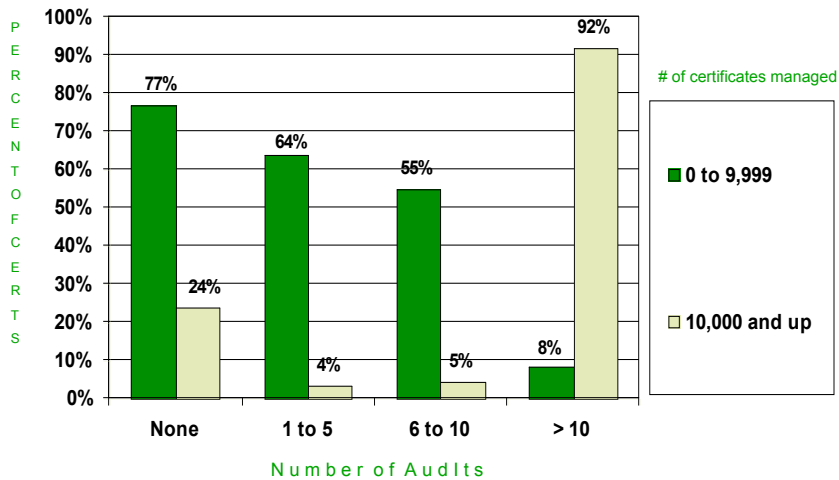


N = 261



### Companies that have more audits manage over 10,000 certificates

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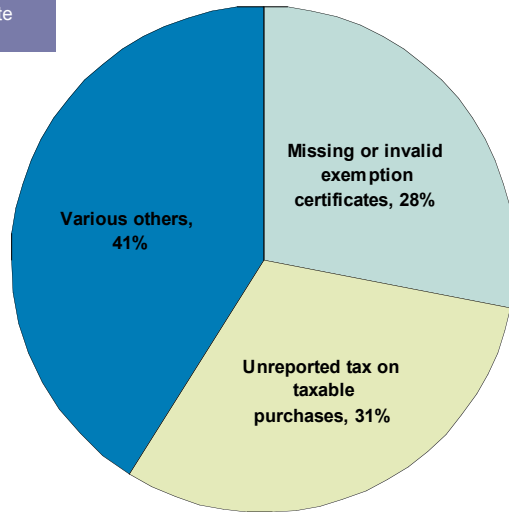




**Unreported tax on taxable purchases and missing or invalid exemption certificates are the single largest contributors to corporate tax professionals audit assessments.**

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Audience: Corporate Tax Professionals



N = 179

% = percent of audit assessment (\$) that is due to the named reason in a typical sales and use tax audit.



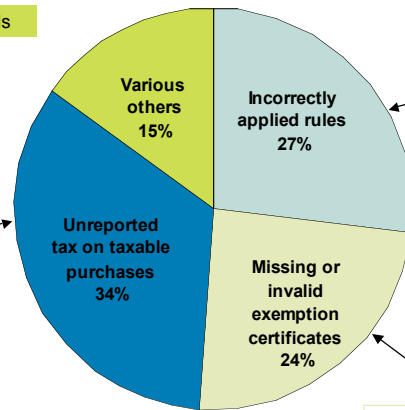
**Audit officials indicate unreported tax, incorrectly applied rules and missing/invalid exemption certificates are the single largest contributors to the audit assessment.**

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Audience: DOR officials

*"Unreported tax on taxable purchases is the biggest area that contributes to the final assessment. There is a lot of incorrect coding of purchases."*

*"Use tax on purchases is the number one area that tends to contribute to a final assessment... many products are brought from out of state... taxes should be paid on these products."*



Incorrect or inconsistent application of tax rules is usually due to taxpayers manipulating "gray" areas, rather than an outright mis-application of the rules.

*"Absent or incomplete exemption certificates are a very common problem." "This is a large one [contributor]. This is a biggy." "Resale and exemption certificates on the sales tax side contribute the lion share to the overall final assessment."*

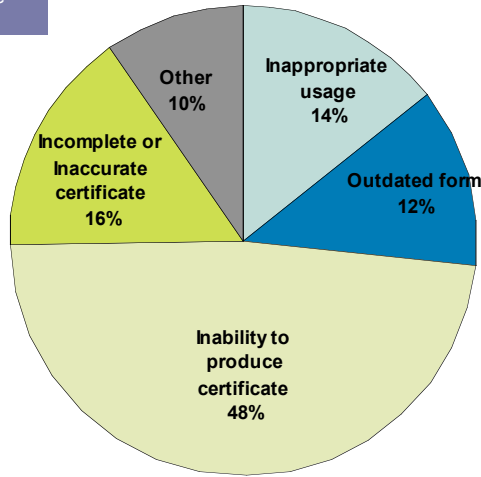
% = amount of contribution to assessment



**When certificates are the reason for the assessment it is most often because corporate tax professionals cannot produce the certificates during audit.**

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Audience: Corporate Tax Professionals



N = 161

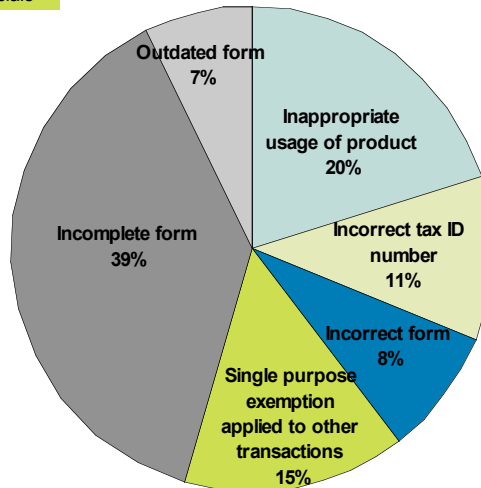
% = Percent of the audit assessment (\$) that was due to the named reason in a typical sales and use tax audit. Relative distribution drawn from open-ended comments.



**When existing certificates are disallowed by the auditor it is most often because the form is incomplete.**

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Audience: DOR officials



N=23

% = Percent of time it occurs in audit



## Typically taxpayers are given 60 days to produce a missing certificate and 70% of the time they meet that deadline.

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Audience: DOR officials

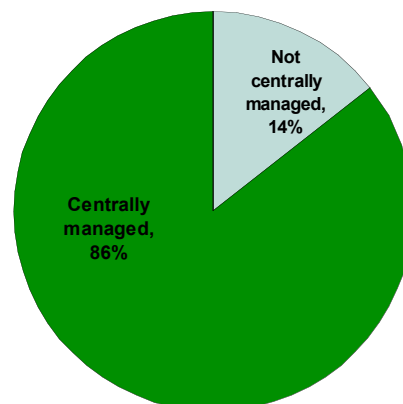
- ▼ **Time normally provided for taxpayers to secure the missing certificates or correct data on invalid certificates is typically 60 days.**
  - *“It is up to the auditor to decide,” “Sixty days is the statute for the amount of time taxpayers have to secure missing certificates or correct data. At the end of 60 days it would become taxable”*
- ▼ **Taxpayers are able to produce the exemption certificate during this time frame about 70% of the time.**
  - *“Eventually the taxpayer is able to produce the customer exemption certificate... this is a huge burden on the taxpayer,” “For multinationals producing valid customer exemption certificates during a given time frame is a problem because of the volume of certificates.”*



## Most companies have centralized the management of exemption certificates

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Audience: Corporate Tax Professionals



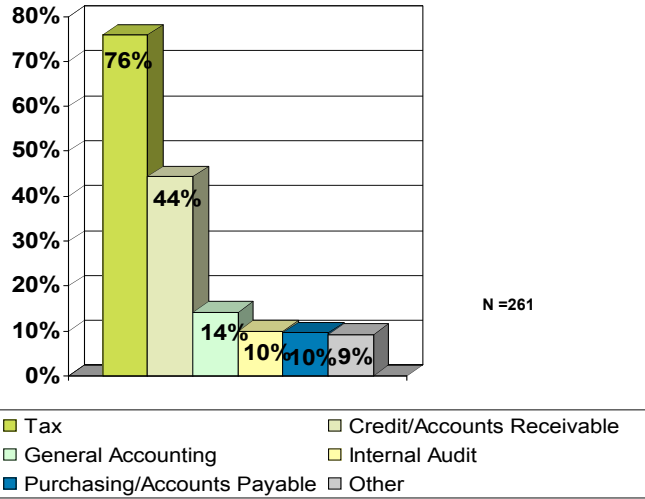
N = 215



### Most often the Tax department requires access to the certificates, but for many, so do Accounts Receivable.

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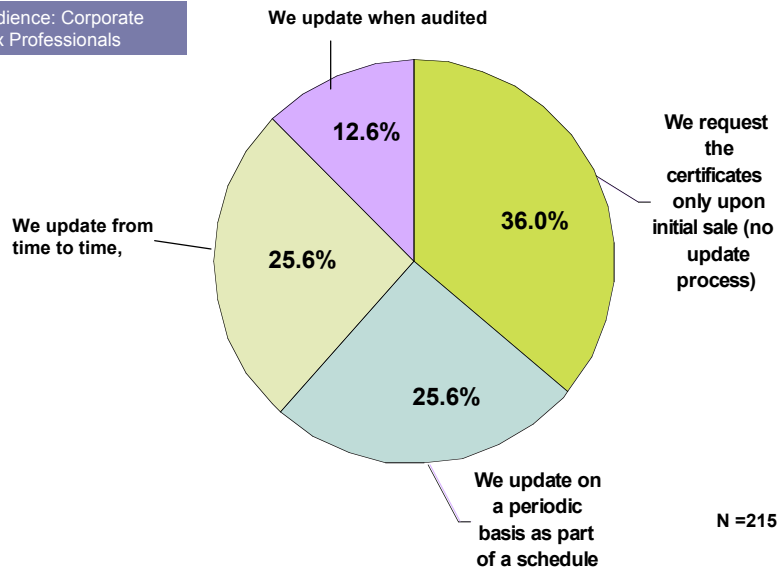
Audience: Corporate Tax Professionals



### Half the companies take a reactive approach to updating certificates.

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Audience: Corporate Tax Professionals

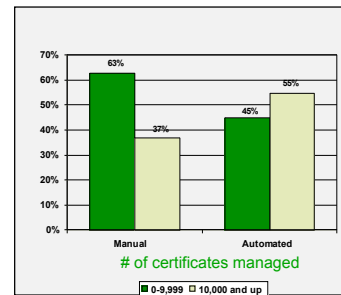
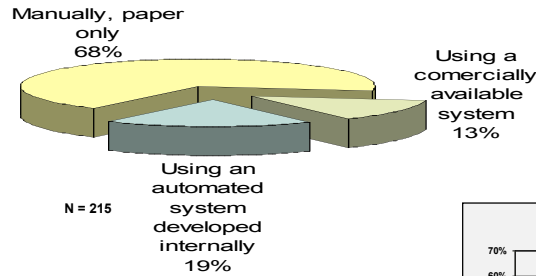




**Two-thirds use manual processes to manage exemption certificates; those companies tend to manage < 10,000.**

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Audience: Corporate Tax Professionals



**Companies say they benefit most from an automated system because it stores and retrieves certificate images allowing for greater audit efficiencies.**

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Audience: Corporate Tax Professionals

Benefits	RANK
Ability to store/retrieve certificate images electronically	1
Ability to plan and organize tax audits more effectively	
Ability to scan paper certificates into electronic form	2
Ability to interface directly with your tax calculation application	
Ability to automate notification process to customers to update certificates	
Compliance with Sarbanes Oxley and other internal control improvement initiatives	3
Ability to provide secure remote access to users including company personnel and external users	

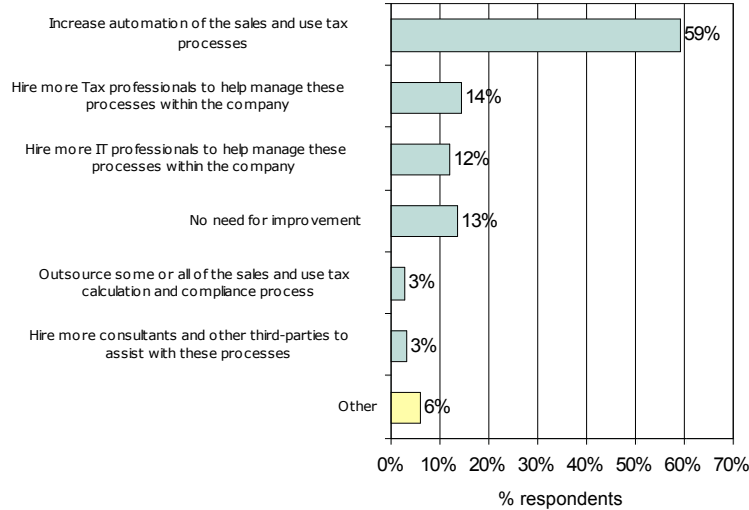
N = 66, due to small sample size the confidence in generalizability of results is reduced.



## Companies would like to replace manual activities with automated processes to improve their tax departments.

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Audience: Corporate Tax Professionals



## DOR officials indicate the positive impact of sales and use tax process automation on their audit processes.

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Audience: DOR officials

### Quotes:

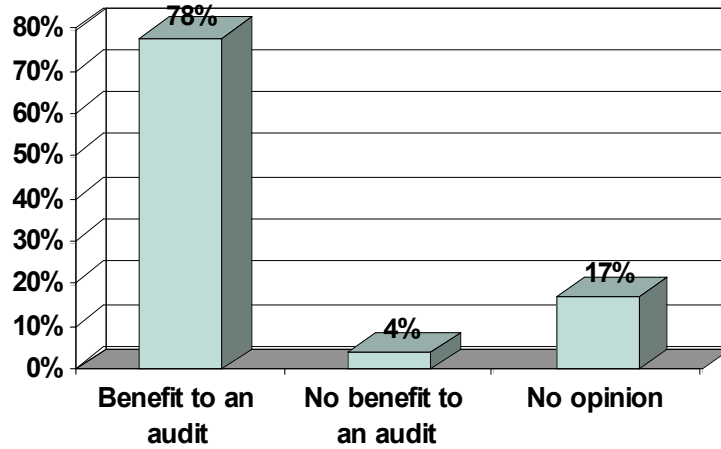
- *“When we audit a company that uses commercial software the records are more accurate and there is more information available... there are fewer problems in fewer areas,”*
- *“Third party automated sales and use tax calculation software has a positive impact on an audit ... we would audit the software primarily,”* • *“Having computerize records is a great benefit to us,”*
- *“The one-stop aspect of a commercial software system and the uniformity of the system are beneficial,”*
- *“If it [the software] has truly captured the results it is a luxury because we do not have to look at source documents”*
- *“We can obtain and reconcile data in statistical electronic samples ...the auditor doesn't have to go out to do the audit,”*



**The majority indicate sales and use tax calculation software is beneficial to their audit processes.**

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Audience: DOR officials



N - 23



**DOR officials indicated that lacking a sales and use tax calculation system contributes to an audit assessment.**

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Audience: DOR officials

**Quotes:**

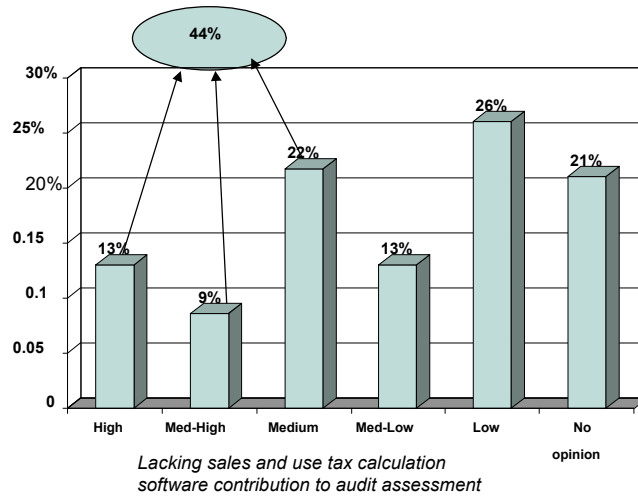
- *“In general, lack of a sophisticated software calculation system contributes to an assessment,”*
- *“If a system is used in a retail business then compliance is high...if a system is not used in a retail business then there is higher possibility of an audit assessment,”*
- *“ The biggest problem is with multi-state entities that use “home-brew” software that is not up to par,”*
- *“The impact on the audit assessment can depend on the extent to which the software tool is implemented and utilized,”*
- *“The better the software, the less liability, the smaller the error,”*
- *“Properly installed a sophisticated, automated calculation system can reduce the audit assessment.”*



**Almost half of DOR officials indicated that lacking a sales and use tax calculation system contributes to an assessment.**

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Audience: DOR officials



N = 23