

Sales and Use Tax Compliance Agreements

A Report of the Steering Committee

*Task Force on EDI Audit and Legal Issues
for Tax Administration*

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FOREWORD

The Task Force on EDI Audit and Legal Issues for Tax Administration (Task Force) was formed to coordinate efforts between the business community and tax administrators in analyzing and addressing the issues posed for tax administration by electronic data interchange and related business processes. The Task Force is comprised of representatives of the Committee on State Taxation (COST), Institute for Professionals in Taxation (IPT), Tax Executives Institute (TEI), Multistate Tax Commission (MTC), and Federation of Tax Administrators (FTA). This report is the *sixth* in a series of Task Force reports on issues relating to electronic commerce, emerging business processes and tax administration. (See Appendix D for other reports in the series.)

As part of the Task Force, the Electronic Business Processes work group was formed to examine the tax administration and compliance issues associated with certain emerging business processes. The work group is also exploring alternative processes that can reduce the burden associated with sales and use tax compliance and administration for taxpayers and taxing authorities alike, one of which is the development of Sales and Use Tax Compliance Agreements (SUTCAs) between taxpayers and taxing agencies.

SUTCAs raise a number of policy and administrative issues. This report is intended to aid both taxpayers and taxing agencies in evaluating and answering those issues. It describes SUTCAs and their operation as well as outlines the perceived benefits and costs associated with them. In addition, the report reviews the major elements likely to be present in a SUTCA and discusses a number of issues that are likely to affect the operation of a SUTCA and, therefore, ought to be considered in arriving at an agreement.

The report concludes by reviewing activities that need to be undertaken in evaluating a SUTCA at the conclusion of its term. The report is intended solely as an educational document for taxpayers and tax administration agencies; it makes no recommendations on whether SUTCAs should be used or the manner in which they might be implemented.

The Steering Committee wishes to acknowledge the contributions of all individuals who devoted their time and effort in developing and refining this report. A complete list of participants can be found in Appendix C.

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SALES AND USE TAX COMPLIANCE AGREEMENTS

A Report of the Steering Committee Task Force on EDI Audit and Legal Issues for Tax Administration

INTRODUCTION

In recent years, American business and government organizations have undergone some radical “re-engineering” and transformation in an effort to improve and streamline their operations. As part of this effort to “do more with less,” both taxpayers and tax agencies have been examining their existing processes to determine if efficiencies and improvements can be made.

Traditional techniques of sales and use tax compliance and administration are, in some cases, prime candidates for such re-engineering efforts. From the taxpayer perspective, traditional approaches to compliance are seen as paper-intensive and labor-intensive with little value. Further, taxpayers find that audits by taxing agencies to determine if they are in compliance involve a significant burden. From the taxing agency perspective, sales and use tax audits are also seen as resource-intensive and time-consuming, particularly when they involve taxpayers that are trying diligently to comply.

As a result, taxpayers and taxing agencies are examining several avenues for simplifying sales and use tax administration and compliance. One approach is for taxing agencies and taxpayers to enter into Sales and Use Tax Compliance Agreements (SUTCAs) with one another. SUTCAs are, at their core, up-front agreements between the taxpayer and the tax authority that detail the manner in which the taxpayer is to calculate and report tax on its purchases and the manner in which tax compliance is to be evaluated on audit. As such, they hold potential for reducing the burden of sales and use tax compliance for all parties.

There is a high level of interest in SUTCAs among taxpayers and taxing agencies. For this reason, the Business Processes Work Group determined it would be advisable to develop this report examining SUTCAs. The report explores the operation of SUTCAs and outlines the perceived benefits and costs associated with them. In addition, it reviews the major elements likely to be present in a SUTCA and discusses a number of issues that are likely to affect the operation of a SUTCA and, therefore, ought to be considered in arriving at an agreement. The report concludes by reviewing activities that need to be undertaken in evaluating a SUTCA at the conclusion of its term.

The report is intended solely as an educational document for taxpayers and tax administration agencies; it makes no recommendations on whether SUTCAs should be entered into or the manner in which they might be implemented.

I. CONSIDERATIONS PRIOR TO ENTERING A SUTCA

A. Sales and Use Tax Compliance Agreement Defined

A Sales and Use Tax Compliance Agreement (SUTCA) is an agreement between a taxing agency and a taxpayer providing simplified procedures under which the taxpayer is to calculate and remit unpaid sales or use tax on its purchases. The agreement commonly provides that the tax to be paid on purchases covered by the agreement is determined by applying an agreed-upon tax rate (determined through a review of the taxpayer's purchasing history) to the aggregate of the taxpayer's covered purchases, rather than being determined on a transaction-by-transaction basis. SUTCAs are known by a variety of names, including managed compliance agreements, effective use tax rate agreements, formulary sales and use tax agreements, negotiated rate agreements, alternative use tax payment methods, and simplified procedure agreements.

SUTCAs are sometimes confused with managed audits because of the similar terminology that is used. While both SUTCAs and managed audits involve cooperation and written agreements between the taxing agency and the taxpayer, there are distinct differences between them. SUTCAs involve an "up-front" agreement specifying the manner in which tax is to be computed and remitted at the time of a purchase, the accuracy of which will be evaluated at a later point. A managed audit, on the other hand, is a post-transaction review in which the taxing agency and taxpayer agree that the taxpayer will audit its own books and records in accordance with procedures established by the taxing agency. Managed audits are conducted in lieu of traditional audits directed by taxing agency personnel. Nevertheless, managed audits adhere to the traditional audit paradigm in their focus on transactions that occurred during past audit periods. SUTCAs, on the other hand, govern the handling of tax obligations on a prospective basis.

B. Operation of a SUTCA

There is no rigid blueprint for the design and implementation of a SUTCA. Instead, it is usually the result of negotiations between the taxing agency and the taxpayer, and both the agency and taxpayer should approach the formulation of a SUTCA with a spirit of flexibility and cooperation. Generally, the taxpayer will present the taxing agency with a proposal from which the parties work in fashioning an agreement that will meet the needs of both parties and comply with the applicable tax laws.

There are three central features to a SUTCA.

- The taxpayer will remit tax on certain categories of its purchases directly to the taxing agency, rather than to its vendors. To this extent, a SUTCA resembles a direct pay agreement.¹
- The tax to be remitted is determined by applying an agreed-upon tax rate or taxable ratio to the total of a taxpayer's purchases rather than determining the taxability of each transaction individually.² The rate or ratio to be applied is determined from an analysis of taxpayer's prior purchase history during a base period that is representative of the taxpayer's operations covered by the SUTCA.³ Through proper analysis of a representative base period, a SUTCA can closely approximate the tax that would be due if it were determined correctly and individually for each transaction, presuming all other relevant elements remain the same.
- Audits of periods covered by a SUTCA do not involve a determination of whether tax was overpaid or underpaid on a transaction-by-transaction basis. They focus instead on determining whether the taxpayer complied with the provisions of the agreement during its term. They also usually involve an evaluation of the degree to which the basis used for tax calculation and remittance in the SUTCA accurately reflected the operations of the taxpayer during the audit period and whether any adjustment to the basis on which tax has been remitted is necessary.⁴

Importantly, all provisions of a SUTCA are subject to negotiation and mutual agreement by the taxpayer and the taxing authority. Other provisions generally in a SUTCA include, but are not limited to, the term and scope of the agreement, procedures for accommodating business and tax law changes, records the taxpayer must maintain as well as provisions addressing reconciliation and possible "true-ups" at the conclusion of the term of the SUTCA.

¹ Direct pay is an authority granted by a tax jurisdiction that generally allows the holder of a direct payment permit to purchase otherwise taxable goods and services without payment of tax to the supplier at the time of purchase. The holder of the direct payment permit is to timely review its purchases and make a determination of taxability and then report and pay the applicable tax due directly to the tax jurisdiction. The permit holder's tax determinations and adequacy of payment are subject to audit by the tax jurisdiction. See also Model Direct Payment Regulation, A Report of the Task Force on EDI Audit and Legal Issues for Tax Administration, February 2000.

² Details regarding the manner in which a SUTCA tax rate is determined as well as other technical features of the SUTCA are discussed in Section II.

³ This may be accomplished by analyzing an appropriate sample of records or conducting a detailed census of the taxpayer's purchase records during the appropriate base period.

⁴ Agreements vary on what action is taken when the basis on which tax was remitted during the period differs from that determined in the audit. Some agreements provide for a "true-up" in the form of payment of additional tax and interest or refund of overpaid tax while others provide that adjustments will be made only on a prospective basis, presuming that other terms of the agreement were met.

C. Potential Benefits of a SUTCA for Taxpayers

Taxpayers are motivated by three general considerations in evaluating the desirability of SUTCAs.

Controlling taxability decisions. SUTCAs enable a taxpayer to better comply with a state's tax laws by moving the determination of which transactions are taxable from the Accounts Payable function where personnel may not have adequate training to the Tax Department where the required expertise appropriately resides. This shift results from the involvement of the Tax Department in the review to determine the basis on which tax is to be remitted under the agreement and in evaluating its accuracy at the conclusion of the agreement.

Reducing compliance burdens. SUTCAs may eliminate the need for a transaction-by-transaction review of all purchases for taxability, thus reducing the requirements in the Accounts Payable function of the organization. Resources associated with this review can be reallocated to a function that creates more value.

Reducing audit burdens. SUTCAs are seen by taxpayers as reducing the cost and burden of traditional sales and use tax audits. Depending on the nature of the base period chosen and the manner in which that period is evaluated, SUTCAs should reduce the detailed examination of vast amounts of transaction records during an audit. In addition, SUTCAs provide some certainty and consistency to the manner in which a taxpayer determines its liability and the manner in which the taxpayer's records are evaluated. This should reduce the risk associated with an audit and consequently reduce the possibility of large assessments with attendant penalties and interest, potential litigation expenses, and allow better budgeting and control of sales and use tax costs.

D. Potential Benefits of a SUTCA for Taxing Agencies

SUTCAs also hold several potential benefits for tax administration agencies.

Reducing audit burden. The most positive aspect of SUTCAs is the potential they have for reducing the costs associated with auditing participating taxpayers, at least in the long term. SUTCAs should reduce the need for detailed examinations of all the records of participating taxpayers. This should allow a reallocation of audit resources to other taxpayers, thus achieving greater coverage with a given amount of resources over the long term.

Improving voluntary compliance. SUTCAs should also contribute to a higher voluntary compliance rate by focusing the efforts of the taxpayer and taxing

agency on evaluating the base period purchase history to determine appropriate compliance levels on an “up-front” basis. Compliance should also be improved by placing technical taxability decisions in the hands of tax professionals.

Promoting cooperative relationships. SUTCAs present an opportunity for taxing agencies to work cooperatively with taxpayers in reducing taxpayer burden and improving overall compliance. Beyond the immediate benefits, this should contribute to a more constructive working relationship over the long term.

E. Potential Negative Aspects of a SUTCA

In evaluating SUTCAs, both taxpayers and taxing agencies need to be cognizant of the level of effort that may be required to develop the initial terms of the SUTCA and to perform the necessary analysis when first entering into a SUTCA. Experience in actual circumstances indicates that developing the requisite level of comfort with the terms of a SUTCA can take time at the outset. Likewise, performing the analysis required to develop the initial SUTCA may take considerable time and effort as various approaches are tried and evaluated. The length of time required on these “up-front” steps is in many ways dependent on the complexity of the taxpayer’s operations and its prior practices in handling its tax obligations. Taxpayers may also need to adjust internal procedures and relationships in implementing a SUTCA. In particular, a SUTCA may affect internal accounting procedures and cause tax costs to be allocated differently than is the case without a SUTCA. These issues should dissipate as both the taxpayer and taxing agency become more familiar and comfortable with the operation of SUTCAs. The degree to which taxpayers change business operations and systems will, however, affect the complexity of SUTCAs over time.

F. Authority of Taxing Agency to Enter into a SUTCA

A taxing agency must consider whether it has the necessary statutory authority to enter into a SUTCA. States have taken different approaches to this issue. South Carolina, for example, has passed a statute explicitly authorizing the agency to enter into SUTCAs. Connecticut created a task force to examine SUTCAs. The task force proposed legislation that was adopted specifically authorizing the taxing agency to enter into use tax compliance agreements.⁵

Other states have taken the approach that the authority of the taxing agency to enter into a SUTCA is implicit in their general sales and use tax administration laws. Most such laws grant taxing agencies the power to adopt administrative

⁵ Connecticut Department of Revenue Services, Managed Compliance Task Force Final Report, January 1999.

rules that do not conflict with the United States Constitution, the state constitution, or state laws. This statutory approach is often interpreted as granting the taxing agency relatively broad discretion to adopt rules that facilitate equitable administration of the tax laws. For example, some taxing agencies have relied on such language to promulgate rules that permit the use of sampling methods to determine tax liability in traditional audits. Such a grant of authority might be interpreted as authorizing use of SUTCAs also.

Finally, some states might enter into SUTCAs by relying on statutory provisions or judicial decisions establishing that the taxing agency can only regulate tax compliance and cannot dictate the way in which a taxpayer conducts its business.

G. Criteria for Determining SUTCA Participation

SUTCAs may not be suitable for all types of taxpayers. Some of the criteria used in evaluating whether a SUTCA may be appropriate for a particular taxpayer are discussed below.

Taxpayers in good standing. Typically, under a SUTCA, the taxpayer will be required to remit tax on purchases to the state rather than to its vendors. As a consequence, taxing agencies will generally limit participation in SUTCAs to taxpayers considered to be in good standing. Such taxpayers will have cooperated with the state's efforts to collect tax, demonstrated a willingness and ability to comply with the tax laws, and maintained an acceptable system of business records.

In a related vein, Connecticut considers perpetually audited taxpayers to be prime candidates for SUTCA participation. As a general rule, these are large taxpayers that face a substantial administrative burden in traditional compliance with sales and use tax laws because of the volume of transactions and the complexity of their operations.

On the other hand, tax authorities are considerably less likely to enter into a SUTCA if the taxpayer's prior history exhibits a failure to cooperate, failure to remedy improper reporting habits, bankruptcy, or potential criminal investigations.

Direct pay permit holders. Taxpayers with direct pay permits are already required to remit tax on purchases directly to the state. Accordingly, some states consider these taxpayers to be uniquely qualified to enter into SUTCAs. In fact, some states have limited participation in SUTCAs to direct pay taxpayers because of the complexity they perceive in dealing with a mix of purchases on which tax is paid to vendors and to the state directly in a SUTCA.

Others have been willing to enter into SUTCAs with non-direct pay taxpayers, despite any complexities.

Accounting properly for purchases on which a taxpayer has remitted tax to its vendors can complicate proper computation of the basis for remitting tax under a SUTCA and evaluation of its ultimate accuracy. Likewise, proper accounting classification may also complicate the operation of the SUTCA on an ongoing basis. The complexity arises from the need to exclude all purchases on which tax was paid to a vendor from the calculation of the initial basis for remitting tax. The examples provided in Appendix A demonstrate the complexity of dealing with a mix of transactions in which tax is directly paid to the vendor and to the taxing authority.

Large volume purchasers. Taxpayers purchasing a large volume of goods or services for their own use are also likely candidates for entering into a SUTCA. A primary goal of the SUTCA is to reduce significantly the time spent by the taxpayer in reviewing individual transactions in order to comply with the laws governing tax on purchases. Consequently, taxpayers with large numbers of transactions experience the greatest benefit from a SUTCA, compared to the cost of implementing and maintaining the agreement.

Administrative capacity of the taxpayer. Some states may require the use of computer assisted audit techniques in the creation of a SUTCA, while other states may not require their use. The ability to capture and extract sufficient electronic data from a taxpayer's accounting and records system to calculate the appropriate basis for remitting tax will be required in situations where computer assisted audit techniques are utilized.

The ability to extract appropriate information for later review may be another influencing factor in the decision to enter into an agreement. The audit trail created by the application of the SUTCA will need to be documented, maintained and made available to the taxing agency upon request.

II. CRAFTING THE AGREEMENT

A. Establishing a Base Period

Developing a mutually acceptable base period and a mutually acceptable scope of purchases to be covered is essential to the establishment of a SUTCA. The taxing agency and taxpayer arrive at the basis on which tax is to be remitted under a SUTCA by analyzing purchases that occurred over the base period. Typically, the base period is a current audit period or a refund period, but the parties may wish to consider transactions occurring over some other period.

When selecting a base period, the most important consideration for the parties is to ensure that purchases occurring within the period are representative of the taxpayer's normal purchasing activity. Short base periods may not accurately reflect the taxpayer's purchasing patterns, particularly where these patterns fluctuate seasonally or cyclically. For example, where a taxpayer's operations vary from season to season, a consecutive three-month sample is not representative.

B. Calculating the Taxable Ratio or Effective Tax Rate

After selecting a representative base period, the parties conduct a review of purchases made within that period and formulate an "effective tax rate" or "taxable ratio" that is to be applied to all purchases, except those specifically excluded from the SUTCA during its term. For purposes of this paper, this review is referred to as the base period analysis. The parties may agree to use the results of a managed audit or a self-audit as the basis for this analysis.

The taxable ratio or effective tax rate determination may be based on sampling or a detailed review of the base period. Various sampling methodologies will be examined in a forthcoming Task Force paper.

The parties may wish to establish more than one taxable ratio or effective tax rate to be applied to different categories of purchases under the SUTCA, rather than excluding various transactions from the agreement altogether, as discussed under Section D below. They may consider establishing different effective rates or ratios based on a taxpayer's subsidiaries or business locations, categories in the taxpayer's chart of accounts, different computer accounting systems used by the taxpayer, or other criteria that make business sense and can produce a reliable and verifiable estimate of use tax liability.

SUTCAs may employ one of two methods to calculate the tax due on purchases.

Under the first method, the taxpayer/taxing agency determines a "taxable ratio" to be applied to the taxpayer's purchases. The ratio is calculated by determining the proportion of taxable purchases in the base period to the total purchases in the base period. The value of purchases subject to tax in a SUTCA is calculated by applying this taxable ratio to a taxpayer's total purchases for the reporting period. The tax to be reported is then derived by multiplying the value of purchases subject to tax by the appropriate state and local tax rate. An illustration of this method is provided in Example A.

Example A: Taxpayer has entered into a SUTCA with Taxing Agency. Pursuant to the terms of the SUTCA, Taxpayer's taxable ratio is 10 percent (assuming base period taxable purchases of \$500,000 and base period total purchases of \$5,000,000). Taxpayer made \$1,000,000 in total purchases in the month of January. Applying the 10 percent ratio to Taxpayer's total January purchases yields total taxable purchases of \$100,000 in January. Assuming the applicable tax rate is 5 percent, Taxpayer's tax liability for January is \$5,000.

Under the second method, the SUTCA establishes an effective tax rate. This rate is calculated by determining the taxpayer's ratio of taxable transactions to total transactions, and then multiplying the applicable tax rate by this taxable ratio to derive an effective tax rate. This method is illustrated in Example B.

Example B: Pursuant to a SUTCA, Taxpayer's taxable rate is 10 percent (assuming base period totals as noted above). Assuming that the applicable tax rate is 5 percent, the taxpayer's effective tax rate is 0.5 percent. This effective tax rate is applied to the taxpayer's total January purchases of \$1,000,000, to calculate a tax amount due of \$5,000.

This method is restated in the formula:

$$10 \text{ percent taxable ratio} \times 5 \text{ percent tax rate} = 0.5 \text{ percent effective tax rate}$$

Examples A and B presume that the taxpayer makes no payments of tax to a vendor at the time of purchases. Examples of the manner in which an effective tax rate or taxable ratio can be computed if tax is paid to vendors on some purchases are provided in Appendix A.

C. Term

Like any agreement between two mutually consenting parties, the SUTCA should specify a term or period of duration. The optimum term for a SUTCA agreement may be the same as the taxing jurisdiction's statute of limitations. While some taxing agencies are willing to enter into a SUTCA term that is co-terminous with the normal audit or statute of limitations period, many are hesitant to agree to a period of this length, especially at the start of the SUTCA. Therefore, many new SUTCAs are set for a shorter period, such as one year. When a shorter term is initially established, the goal should be to agree to a longer term after a few successful reviews are conducted.⁶ If the term of a SUTCA extends beyond the

⁶ If a taxpayer entering a SUTCA has recently been issued a direct pay permit, it may be difficult to arrive at a "representative" base period. In such cases, some states have used a short base period, but have

statute of limitations, waivers of the statute should be considered as the terms are negotiated.

The parties may agree to leave the term of the agreement open-ended. Nevertheless, in practice it is likely that the taxing agency may be more receptive to an agreement that has a specified term, but that also provides that the parties may agree to extend the agreement beyond the specified term without conducting a review at the end of the term.

D. Atypical Transactions

Accounts or transactions that are not representative of the taxpayer's routine purchasing patterns require special treatment in a SUTCA. Atypical purchases may skew the taxable ratio or effective tax rate and negate the validity of the SUTCA. These types of purchases are generally dealt with in one of two ways – either a unique taxable ratio or effective tax rate is computed for atypical categories of purchases or they are excluded from the SUTCA entirely. The choice of a special rate/ratio or exclusion will be made jointly by the taxing agency and the taxpayer and will depend on the frequency of the purchases and other relevant characteristics. The taxing agency and taxpayer may also agree to exclude other categories of transactions due to the unique accounting and compliance practices involved.

Accounts or transactions that the parties may wish to consider “atypical” in the operation of a SUTCA include, but are not limited to, the following items:

Capital assets. Parties to a SUTCA may wish to consider capital assets or certain types of capital purchases as atypical in the operation of the SUTCA for several reasons. First, expensive, non-recurring capital asset purchases are likely to skew the taxable ratio or effective tax rate. Moreover, certain states may be entitled to tax capital asset purchases at a different rate from the general tax rate on which a SUTCA is based. In addition, classifying capital asset purchases may be difficult due to the differences between state tax approaches to purchases of tangible personal property and purchases of real property. Finally, some taxing agencies are prevented by law from applying an effective tax rate to capital asset purchases.

Purchases exceeding a threshold amount. As with capital assets, the primary rationale for excluding costly purchases from the SUTCA is that the

provided also that the term of the initial SUTCA will be short so that the agreed upon tax rate can be evaluated sooner rather than later.

taxable ratio or effective tax rate may be skewed by high-cost, nonrecurring purchases.

Telecommunications or utility services. The taxation of telecommunications and utilities is an evolving and complex area of the law. Because of the likelihood of disputes and law changes in this area, these services are often excluded from the operation of the SUTCA. For similar reasons, the Task Force’s model regulation on “direct pay authority” recommends that telecommunications and utilities be excluded from direct pay authority.⁷

Exempt items where refund necessary. In some states, a taxpayer may claim exemption for certain items (e.g. manufacturing equipment and machinery) only through a refund of previously paid tax. Where the law requires payment of the tax before a refund will be granted, a SUTCA cannot exonerate the taxpayer from liability for paying the tax up-front. Accordingly, these items can be handled more efficiently outside the scope of the SUTCA.

Major construction projects. Taxing agencies may be reluctant to bring major construction projects within the ambit of the SUTCA, due to the non-recurring nature of major construction projects and the difficulties associated with distinguishing between real property and tangible personal property.

Procurement card purchases. Tax compliance and accounting practices for procurement card⁸ purchases may be different from traditional purchases. Corporate procurement card programs are continually evolving and taxing agencies have only recently been exposed to procurement card transactions within the audit process. Therefore, the taxpayer and taxing agency may determine that procurement card transactions would be better handled outside the scope of the SUTCA or through a separate effective rate or taxable ratio for such purchases.

⁷ See Model Direct Payment Regulation, A Report of the Task Force on EDI Audit and Legal Issues for Tax Administration, February 2000.

⁸ Procurement cards are corporate charge cards issued to specific employees to purchase designated goods and services on behalf of the company. Procurement card programs can effectively simplify and streamline the procurement process by replacing the various steps in the traditional purchasing process with an authorization to an employee to use a charge card to procure the necessary goods and services. See also Procurement Cards And Tax Compliance: Bridging The Gap, A Report of the Steering Committee, Task Force on EDI Audit and Legal Issues for Tax Administration, published June 1997.

E. Recognizing Local Tax Issues

The rules for imposition of local taxes vary among states and can present complex issues for the taxpayer and taxing agency. The application of local taxes should be addressed in the SUTCA.

Where a purchase actually occurs in a particular municipality or county, the law provides for the imposition of local tax at the rate applicable in that municipality or county. Often, however, transactions may involve more than one municipality or county. For instance, if a taxpayer operating in county A orders goods from a seller located in county B, the taxing agency must determine which county's tax will apply.

In some states, local taxes are imposed at the purchaser's location. Such taxes, called destination taxes, are based on the rate applicable in the municipality or county where the taxpayer is situated. Destination taxes present no administrative problems for the taxing agency and taxpayer contemplating a SUTCA. Indeed, the taxpayer is most likely to be familiar with the local taxes in its own location.

Conversely, origination taxes are local taxes imposed at the seller's location. These taxes can create practical accounting problems for the taxpayer and the taxing agency. Origination taxes will vary depending upon the seller's location. Furthermore, some taxpayers may be less familiar with the local taxes applicable in the seller's jurisdiction, and thus more likely to calculate origination taxes incorrectly.

Regardless of the nature of the local tax, effective design and operation of the SUTCA will require the examination and evaluation of local tax issues during the analysis of the base period for purposes of determining the basis on which tax is to be remitted under the SUTCA. That is, the "normal" pattern of a taxpayer's purchases as it relates to location and use will need to be analyzed along with the taxable nature of the purchases.

F. Recordkeeping Requirements

The SUTCA should specify the records to be kept by the taxpayer. At a minimum, the taxpayer should keep for review by the taxing agency all work papers involved in calculating the taxable ratio or effective tax rate. Although the taxing agency will already have reviewed these papers during the base period analysis, the parties will need to consult the papers whenever revisions to the SUTCA are necessary.

The taxpayer will still be required to maintain records that meet the general requirements of state law. The agreement may address the types of records to be maintained and the manner in which the state taxing agency is to be provided access to them. The parties may wish to incorporate by reference sections of the Model Recordkeeping and Retention Regulation.⁹ This regulation defines the taxpayer's obligation to retain all records necessary to the correct determination of the tax liability and to make such records available to the taxing agency upon request. Each taxing agency may list specific types of records or specific tax elements or transactions for which particular records may be required.

The taxpayer may also be required to sufficiently document the process used to establish the taxable ratio or effective tax rate. The taxpayer may also be required to provide a record of significant business, law, accounting, and other changes that occur during the SUTCA term and that affect the taxable ratio or effective tax rate calculation. If these requirements are not met, a taxing agency may deem a SUTCA null and void.

Some taxing agencies may not require the taxpayer to maintain the same records it would have to keep absent the SUTCA. Instead, the taxing agency may agree to test the taxpayer's internal control system, and to reduce the number of tangible records to be maintained by the taxpayer. If the taxing agency opts for this approach, the taxpayer's records should be separated for different types of accounting methods.

G. Taxpayer Business Changes Affecting the SUTCA

An underlying assumption of any compliance agreement is that the activities of the taxpayer will remain relatively static throughout the term of the agreement. If there is a significant change in the taxpayer's operations, an adjustment to the taxable ratio or effective tax rate may be necessary to maintain the accuracy of the taxpayer's compliance, and the validity of the SUTCA. Any obligations on the taxpayer to report such changes to the taxing agency as well as the procedures to be followed in making and reporting adjustments to the agreed upon SUTCA report should be outlined in the agreement.

Accordingly, at the start, the parties to the agreement should define what constitutes a "significant change" in the company's business operations and what actions the taxpayer should take in notifying the taxing agency and/or adjusting the taxable ratio or effective tax rate in the event of such changes. Significant changes

⁹ See Model Recordkeeping and Retention Regulation, A Report of the Steering Committee, Task Force on EDI Audit and Legal Issues for Tax Administration, published March 1996.

should only include business changes that affect the taxable ratio or effective tax rate of the accounts subject to the agreement. In fact, the utility of the SUTCA will be greatly diminished if the taxpayer is under a constant duty to report changes of limitless scope. Examples of “significant” changes that may be addressed in a SUTCA include the following.

Discontinuation or startup of manufacturing or support facilities. A temporary or permanent termination of a taxpayer's manufacturing or support facilities within the jurisdiction of the SUTCA will significantly alter the purchasing habits of the taxpayer. While accounts including only purchases of items used in processes that were shutdown will become inactive, accounts including items used both in these processes and in other processes will change significantly.

The ratio of exempt purchases to taxable purchases within these accounts will change. Failure to account for these changes could render the taxable ratio or effective tax rate invalid and expose the taxpayer to significant compliance issues.

A startup or a significant expansion of manufacturing or support facilities may alter the ratio of the taxpayer's input purchases. Where accounts are opened for, or affected by, purchases, the taxpayer will generally experience a change in the ratio or in the number of non-taxable purchases made. The SUTCA should address the actions to be taken in such circumstances.

Significant activities transferred to, or taken from, a contractor. In most jurisdictions, contractors are considered the end users of materials purchased for use in the fulfillment of their contracts. Contractors are thus responsible for remitting tax on these materials. If a taxpayer transfers significant business operations, including significant capital improvement projects or maintenance operations, to a third party contractor, the taxpayer will transfer significant use tax burdens as well. Closing or changing accounts related to these projects will reduce the number of taxable purchases made. The taxable ratio or effective tax rate will be rendered invalid.

On the other hand, if a taxpayer absorbs activities previously performed by third-party contractors, the taxpayer will become responsible for the use tax on the materials used in the performance of such activities. This influx of taxable purchases will create new accounts or affect existing accounts. If the taxpayer adheres to the terms of the SUTCA, underpayment is likely to occur. Again, the SUTCA should address the actions to be taken in such circumstances.

Cost containment programs. Many taxpayers implement cost containment programs that affect purchasing activities. For example, a taxpayer

may establish a separate entity to perform all purchasing functions for an affiliated group. When these programs are implemented, purchasing activities may be centralized and the destination and initial point of use or storage of materials may change. Temporary storage provisions in many state statutes create use tax liability in the jurisdiction where the centralized purchasing occurs. This additional liability may render invalid the taxable ratio or effective tax rate. Implementation of a cost-containment program may affect the operation of the SUTCA.

Mergers and acquisitions. Clearly, any significant business restructuring activities, such as mergers and acquisitions, will affect the types and volume of purchases a taxpayer makes. Depending on how similar the activities of the merged or acquired company are to those of the taxpayer, the restructuring could significantly change the types of purchases made, either because new items will be purchased, or because traditional items will be used for additional purposes. In either case, the terms of the SUTCA probably will not accurately reflect the new ratio of taxable to nontaxable purchases. Where two entities merge to create a single entity with a new corporate identity, the new entity will need to negotiate and enter into its own SUTCA with the taxing agency. If both merging entities had separate SUTCA agreements with the taxing agency prior to the merger, fashioning a SUTCA for the new entity should be a relatively straightforward process.

Significant financial or accounting changes. Significant financial or accounting changes must be reviewed to determine their impact on the agreement. For example, a significant change in a company's accounting systems may change the types of purchases charged to accounts that existed at the time of the consummation of the SUTCA by adding new accounts or modifying existing accounts to include a new array of purchases.

The taxpayer should periodically review its business operations pursuant to the SUTCA for significant changes such as those noted above. The SUTCA should address the actions the taxpayer should take in the event the taxpayer experiences significant changes in its operations.

H. Amending the SUTCA

Before the parties enter into a SUTCA, they should agree upon and specify in writing the circumstances that may give rise to a need for amendments to the SUTCA. These circumstances may include: changes in the applicable law including, but not necessarily limited to judicial decisions, legislative enactments, administrative changes that affect the calculation of the taxable ratio or effective

rate, and, operational changes that affect the key provisions of the SUTCA (taxable ratio or effective tax rate). (See Section G above.)

Only changes affecting the taxable ratio or effective tax rate, and not inconsequential changes in the applicable law or business operations, necessitate amendments to the SUTCA.

I. Canceling the Agreement

Normally, cancellation by either party upon written notification should be permissible. However, the agreement may require reasonable notice. As a practical matter, the taxing agency may be content with relatively short notice of cancellation by the taxpayer. After all, if the SUTCA is canceled, the agency will simply expect the taxpayer to report in accordance with the state law for similarly situated taxpayers.

The taxpayer, on the other hand, may need more notice of the taxing agency's decision to cancel the SUTCA. The taxpayer may have made business decisions, such as personnel changes, in reliance on the SUTCA. If the taxing agency decides to cancel the agreement, the taxpayer may need time to train its personnel to operate in a new environment. Moreover, the taxpayer may need to change its reporting methods and computer systems, and it may encounter unforeseen administrative difficulties. This is similar to the consideration that must be given the taxpayer in discontinuing a direct pay permit. The parties may wish to consider a specific time period for a tax authority to revoke a SUTCA in the absence of serious noncompliance such as negligence or fraud.

III. POST-SUTCA ISSUES

A. Subsequent Review

As previously discussed, most SUTCAs have a set term. At the conclusion of this term, the parties may conduct a review before formulating a new agreement or extending the old one. This review will primarily consist of two parts.

First, the agency must determine whether the taxpayer is reporting and remitting tax in accordance with the agreement. Second, the parties must determine whether the taxpayer's purchasing and business activities throughout the term of the agreement were similar to those activities at the start of the agreement. If any significant changes in the operations or structure of the company have occurred or if there have been significant law or policy changes, the parties will need to revise the taxable ratio or the effective tax rate. (See discussion in Section G above.)

Prior to the review stage, the parties should define the procedures to be employed and the involvement of each party in the process. The decision as to what procedures constitute a satisfactory review may ultimately rest with the taxing agency, or may be dictated by state law. Regardless of who performs the review and the nature of the review, the parties should agree up front that any changes to the agreement must be approved by both parties.

The results of this review can be the basis for: (1) a new taxable ratio or effective tax rate to be used on a prospective basis, presuming the SUTCA is continued; and (2) a post-SUTCA reconciliation or verification.

If the parties are unable to reach a new agreement at the end of the original SUTCA term, the agreement will expire. The parties will return to the traditional model of sales and use tax compliance.

B. Verification

A major item that should be discussed and agreed to as part of a SUTCA is whether to conduct some form of verification upon expiration of the agreement. This verification process may also be known as a “true-up” or a “reconciliation.”

Objectives. Verification procedures are designed to compare the amount of tax remitted under the terms of the SUTCA to the amount of tax that would have been due without a SUTCA. Without a SUTCA, the tax would be determined on a transaction-by-transaction basis, and audited by the state in a traditional sales and use tax audit.

Five purposes for verification procedures are:

- (a) determining the degree to which the taxpayer complied with the reporting provisions agreed to in the SUTCA;
- (b) determining the degree to which the taxable ratio or effective tax rate estimated at the outset of the SUTCA inception accurately reflected the actual amount of tax that would have been due on the purchases made during the period;
- (c) estimating the amount of additional tax owed to the taxing agency;
- (d) estimating the amount of refund due to the taxpayer; and
- (e) determining an effective tax rate or taxable ratio to be used on a prospective basis should the SUTCA be continued.

Sampling. Sampling is an important issue in the verification procedure and in considering the need to perform the verification procedure. The sample that establishes a prospective taxable ratio or effective tax rate for the SUTCA is drawn from transactions that occurred in periods prior to inception of the SUTCA. The verification procedure uses a sample drawn from transactions that took place during the period covered by the SUTCA. These two samples may differ because of changes in the taxpayer's business operations, accounting procedures, tax law changes, and other factors.

Even if no changes occurred over the period of the SUTCA, some risk exists that different samples will result in different estimates. Whenever sampling techniques are utilized, an estimate of the actual result of a detailed review of a population is being made. If statistical sampling techniques are utilized, the results of the sample may be statistically evaluated to determine how accurately the sample represents the population. If nonstatistical techniques are utilized, the evaluation of the sample depends on subjective judgment. Regardless of the sampling method, some form of estimation is being applied. The parties to the SUTCA should consider how much sampling risk they are willing to tolerate and the costs of reducing that risk.

Design. Some taxing agencies may require taxpayers to commit to verification procedures before entering into a SUTCA. Similarly, some taxpayers may want to pre-commit to verification procedures, while others may not believe this to be necessary. As taxing agencies and taxpayers gain more experience with SUTCAs, both parties may develop more effective and efficient methods of verification.

Design of the verification procedures should consider the following:

- (a) records to be maintained by the taxpayer and made available for verification;
- (b) reconciling transactions covered by the SUTCA to the taxpayer's general ledger accounts;
- (c) coordination of the SUTCA verification with the audit of accounts and transactions excluded from the SUTCA;
- (d) statistical or nonstatistical sampling methods that will be used in the verification procedures;
- (e) sharing of responsibility for performing verification procedures between the taxing agencies, taxpayers, or third parties;

- (f) potential adjustments to the verification procedures for major events, such as corporate restructuring, tax law changes, or accounting system changes;
- (g) adjustments for local tax rates that may change more frequently than the state tax rate; and
- (h) timeline for completing verification procedures.

Making Adjustments. If adjustments are provided for in the SUTCA, clear understandings between the taxing agency and the taxpayer should be reached on how tax, penalties, and interest will be determined and potentially adjusted as a result of the verification procedures. One possible method is to specify three different outcomes based on the magnitude of the difference between the tax paid under the terms of the SUTCA and the tax that is estimated to have actually been due based on a post-SUTCA review. Such an approach could be structured as follows; the percentages to be used for each of these levels may be negotiated between the two parties or a standard may be set by the taxing agency.

- (a) If the difference is less than X percent, the difference is not significant and no adjustment will be made due to the accuracy of the SUTCA.
- (b) If the difference is between X percent and Y percent, an adjustment may be made. The taxpayer and taxing agency may agree to settle up the difference whether it be underpaid or overpaid tax. The payment of interest by either party would be negotiated as well, unless prohibited by statute.
- (c) If the difference exceeds Y percent, an adjustment would be made. The underpaid or overpaid tax would be paid along with interest at the rates specified by the relevant statute. Penalties may or may not be charged depending on the SUTCA.

Timing. The timing of the verification procedures of a SUTCA period process will be important in situations where the verification of one period will be used to determine the effective tax rate for the next SUTCA period. There will be an overlap between the verification process and the beginning of the next SUTCA period in most instances. This may be the case when the verification procedures begin prior to the end of the SUTCA period as well as when they are begun after the end of the SUTCA period. A provision may be needed to adjust payments in the new SUTCA period after the new taxable ratio or effective tax rate is determined. If disputes arise in the verification process, delays may occur while administrative or judicial appeals are settled.

For example, assume the first SUTCA period covers years Y1 and Y2, and the second SUTCA period covers years Y3 and Y4. If the verification procedures for the first period (Y1-Y2) are not completed until the middle of year Y3, then the

taxable ratio or effective tax rate for the second period (Y3-Y4) will not be finalized until several months after the commencement of that period. To maintain accurate reporting, some adjustment method would be required part way through the second SUTCA period after the new taxable ratio or effective tax rate is determined.

C. Dispute Resolution

The SUTCA should specify the manner in which disputes between the taxing agency and the taxpayer will be resolved. As a matter of law, a taxpayer entering into a SUTCA with a taxing agency should have the same protest rights as other taxpayers. The fact that a taxpayer enters into an agreement should not deprive the taxpayer of the protest rights enjoyed by taxpayers under the relevant laws of the state.

Just as entering into a SUTCA will not deprive the taxpayer of the protest rights granted all taxpayers under the applicable law, the taxpayer probably will not be granted additional avenues of protest under the SUTCA. The protest rights of taxpayers are generally set forth by the legislature and codified in state law. Even a taxing agency with some latitude in determining the protest avenues available to taxpayers, however, would be reluctant to create additional protest rights for a taxpayer that has entered into a SUTCA with the taxing agency. Granting additional protest rights to such taxpayers arguably would grant such taxpayers an advantage over those to whom SUTCAs were not available. Accordingly, the taxpayer's protest rights will probably be limited to those already available under state law.

Appendix A

Calculating an Effective Tax Rate or Taxable Ratio When Tax is Paid to Vendors on Some Transactions

The following examples are intended to demonstrate the complexity of dealing with a mix of transactions in which tax is directly paid to the vendor and to the taxing authority.

Example B1. Taxpayer, who holds a direct pay permit and reports tax on a monthly basis, wishes to enter into a SUTCA with Taxing Agency. Taxpayer had \$1,000,000 of operating and maintenance expenses during the base period. These expenses fall under fifteen separate classifications, including office supplies, repairs of machinery and equipment, and janitorial expenditures.

Because Taxpayer has a direct pay permit, Taxpayer purchased all items tax-free. By analyzing all of Taxpayer's purchases to determine which purchases are taxable, Taxpayer and the Taxing Agency will determine the taxable ratio to be used in the SUTCA.

Assume Taxpayer's taxable rate is 75 percent. This 75 percent will apply to every individual item, and to the total purchases. Assume further that Taxpayer makes \$100,000 of purchases in January. Applying the 75 percent rate to Taxpayer's January purchases yields total taxable purchases of \$75,000 in January. If the applicable use tax rate is 6 percent, Taxpayer's use tax liability for January is \$4,500.

Example B2. Taxpayer, who reports tax on a monthly basis but does not hold a direct pay permit, wishes to enter into a SUTCA with Taxing Agency. Taxpayer had \$1,000,000 of operating and maintenance expenses during the base period. These expenses fall under fifteen separate classifications, including office supplies, repairs of machinery and equipment, and janitorial expenditures.

Because Taxpayer does not hold a direct pay permit, Taxpayer pays tax to the vendor on at least some of its taxable purchases. In order for Taxpayer and Taxing Agency to determine the taxable ratio to be used in the SUTCA, they will analyze all transactions to determine which purchases are taxable. In addition, however, the parties will have to isolate the amount of tax paid by Taxpayer to its vendors and credit the amount paid against tax actually due. Arriving at a taxable rate for a taxpayer not granted direct pay authority, then, is a cumbersome process. At least some of this cumbersome procedure will be repeated monthly, as Taxpayer attempts to determine the amount of tax due to Taxing Agency.

Again, assume Taxpayer's taxable rate is 75 percent, and that Taxpayer makes \$100,000 of purchases in January. Taxpayer will first want to calculate the amount of tax remitted to vendors on its January purchases. Employees of Taxpayer will have to examine each individual invoice to determine the amount of tax paid. Assume that Taxpayer conducts an exhaustive review of its records and determines that it paid its vendors \$3000 in use

tax on its January purchases. Then, applying the 75 percent rate to Taxpayer's January purchases yields total taxable purchases of \$75,000 in January. If the applicable use tax rate is 6 percent, Taxpayer's use tax liability for January is \$4,500, less the \$3,000 paid to Taxpayer's vendors. Taxpayer owes \$1,500 in use tax to the state.

Alternatively, one could try to compute an effective tax rate for all transactions including those for which tax was paid directly to the vendor. This would in all likelihood add variability and imprecision to the computation of the effective tax rate for the SUTCA. That is, it is more likely that the proportion of purchases that will be made from a particular vendor or vendors to whom tax is paid will vary from period to period (e.g., because of changes in vendors or changes in the operation of continuing vendors) than it is that the general mix of the taxpayer's purchases, in the aggregate, will vary.

Summary of State Practices

	<i>ALABAMA</i>	<i>ALASKA</i>	<i>ARIZONA</i>	<i>ARKANSAS</i>
Agency Contact	Ernest Broadhead (334) 242-1576			John Theis (501) 682-7000
<i>Does state require legal authority to enter into a SUTCA? If yes, is authority in place?</i>	Legal authority not required.	No Sales Tax		Yes Yes
<i>Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?</i>	Yes Pending			Considering No
<i>What criteria is used to determine whether a SUTCA will be considered?</i>	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Computerized records; Agreement on sampling procedures			Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Agreement on sampling procedure:
<i>Number of SUTCAs in place? Number of SUTCAs pending?</i>	2 in place 4 pending			0 in place 0 pending
<i>General term of SUTCA</i>	3 years; initial review takes place in 18 months.			Undecided
<i>For base period analysis, does agency detail or sample transactions? Who performs analysis?</i>	Sample is performed by the taxpayer with tax authority review/approval.			Undecided; currently negotiating with taxpayer representative.
<i>List accounts specifically excluded from the SUTCA</i>	Capital assets; Purchases for resale; Telecommunications; Utilities; Construction projects; Corporate procurement card			Undecided

Sales and Use Tax Compliance Agreements: Summary of State Practices

	ALABAMA	ALASKA	ARIZONA	ARKANSAS
	purchases			
<i>Are local taxes addressed?</i>	Yes; imposed at purchaser's location. Generally, we have considered only expenses of manufacturers as being eligible procedure.			Undecided
<i>How are significant business changes addressed?</i>	Taxpayer adjusts ratio or rate and maintains supporting documentation for subsequent review by agency.			Undecided
<i>How are discrepancies in tax handled?</i>	Require reconciliation of tax if beyond specified dollar threshold.			Require reconciliation of tax
<i>Additional Comments</i>				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>CALIFORNIA</i>	<i>COLORADO</i>	<i>CONNECTICUT</i>	<i>DELAWARE</i>
Agency Contact		Phil Spencer (303) 355-0400 x-213	Paul Greenfield (860) 541-7573	
<i>Does state require legal authority to enter into a SUTCA? If yes, is authority in place?</i>		Yes No	Yes Yes; 1999 Conn. Pub. Acts 173 (sec. 60 through 63) as amended by 1999 Conn. Pub. Acts 1, June Special Session (sec. 41 & 42). Both acts enclosed with survey.	No Sales Tax
<i>Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?</i>		No. Direct Pay will be implemented beginning 1-1-2000. SUTCAs may evolve after that time.	Pending. Procedures/implementation will be available in late fall, with MCAs to be entered into commencing Jan. 2000.	
<i>What criteria is used to determine whether a SUTCA will be considered?</i>			See definition of "eligible taxpayer" in 1999 Conn. Pub. Acts 173, section 60.	
<i>Number of SUTCAs in place? Number of SUTCAs pending?</i>			0 0	
<i>General term of SUTCA</i>			3 years	
<i>For base period analysis, does agency detail or sample transactions? Who performs analysis?</i>				
<i>List accounts specifically excluded from the SUTCA</i>			In development stage	
<i>Are local taxes addressed?</i>			No. Connecticut municipalities do not impose local sales taxes.	
<i>How are significant business changes addressed?</i>			In development stage	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>CALIFORNIA</i>	<i>COLORADO</i>	<i>CONNECTICUT</i>	<i>DELAWARE</i>
<i>How are discrepancies in tax handled?</i>			<i>Require reconciliation of tax if beyond specified dollar threshold. See 1999 Conn. Pub. Acts 1, June Special Session, section 41.</i>	
<i>Additional Comments</i>			<i>Available to offer insight once we have developed our business rules and begun implementation.</i>	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	DISTRICT OF COLUMBIA	FLORIDA	GEORGIA	HAWAII
Agency Contact	Gregory Barcase (202) 442-6579		Edward M Many (404) 651-5417	
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?	Legal authority not required		General powers of the Commissioner are sufficient.	
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Agency has entered into one or more SUTCAs. Formal procedures are in place.		Yes Informal policies have been established by the Compliance Division.	
What criteria is used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Business need demonstrated; Agreement on sampling procedures		Taxpayer in good standing Business need demonstrated Direct Pay Permit Holder Perpetually audited taxpayer Manufacturer Agreement on Sampling Procedures Registration of all locations in state	
Number of SUTCAs in place? Number of SUTCAs pending?	20 in place 3 pending		2 MoUs signed, but not implemented 2 MoUs in process	
General term of SUTCA	3 years; 5 years if egregious		Agreement will be indefinite, but percentages will be reviewed every 18-24 months	
For base period analysis, does agency detail or sample transactions? Who performs analysis?	Detail or sample performed by taxpayer with tax authority review		Sample Taxpayer submits detailed parameters of sample to agency for review prior to selecting sample and beginning analysis.	
List accounts specifically excluded from the SUTCA	N/A		Capital assets Purchases for resale Telecommunications and Utilities Construction projects Corporate procurement card purchases	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>DISTRICT OF COLUMBIA</i>	<i>FLORIDA</i>	<i>GEORGIA</i>	<i>HAWAII</i>
<i>Are local taxes addressed?</i>	N/A		Local taxes are imposed at the monthly rate in the purchaser's location	
<i>How are significant business changes addressed?</i>	Taxpayer notifies agency; adjustments made going forward		Taxpayer is responsible for monitoring its operations and submitting potential changes to the agency.	
<i>How are discrepancies in tax handled?</i>	Adjustments made going forward only		Other than for material changes, no refund or additional tax is anticipated. Parties have right to review period covered by agreement, and subject to agreement of both parties there could be payment of refund or additional tax.	
<i>Additional Comments</i>	Voluntary compliance agreements add taxpayers to the District's registration database and provide future revenue streams for the city.		Agreements require considerable amount of up-front work by taxpayer and tax agency.	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	IDAHO	ILLINOIS	INDIANA	IOWA
Agency Contact		Keith Staats (217) 785-5237		David Casey (515) 281-6163
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?		Summary of Illinois response: Currently, the department would not be able to enter into any type of compliance agreement when anything but the actual amount of tax due is collected from the taxpayer. The department believes statutory changes would be required before these agreements could be considered.	Yes Yes	Yes; by rule Yes
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?			Yes Yes	Considering; no formal policies at time.
What criteria is used to determine whether a SUTCA will be considered?			Taxpayer in good standing Direct Pay Permit Holder Manufacturer Large Volume Business Computerized Records Agreement on Sampling Procedures	Taxpayer in good standing; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases; Agreement on sampling procedure:
Number of SUTCAs in place? Number of SUTCAs pending?			32 in place 15 pending	0 in place 1 pending
General term of SUTCA			3 years	No set years; number of years will negotiated.
For base period analysis, does agency detail or sample transactions? Who performs analysis?			Sample performed by tax authority with taxpayer review/approval	Sample is performed by the taxpayer with tax authority review/approval.
List accounts specifically excluded from the SUTCA			Capital assets; Inventory; Payroll; Professional services	Purchases for resale; Telecommunications; Utilities: Construction projects; Motor vehicles - purchased or lea:

Sales and Use Tax Compliance Agreements: Summary of State Practices

	IDAHO	ILLINOIS	INDIANA	IOWA
<i>Are local taxes addressed?</i>			N/A	Yes; imposed at purchaser's location. Local option tax is based on the delivery of the goods and services to the local option jurisdiction. The agreement will include tax due on local option if the purchaser is located in local option tax jurisdiction.
<i>How are significant business changes addressed?</i>			Taxpayer notifies the agency; ratio is adjusted going forward	Taxpayer notifies agency; ratio or rate is adjusted going forward.
<i>How are discrepancies in tax handled?</i>			Adjustments made going forward only	There is no set guideline. Expect this issue to be handled in the final agreement.
<i>Additional Comments</i>				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	KANSAS	KENTUCKY	LOUISIANA	MAINE
Agency Contact	Robert Lewis (785) 296-7487		Kurt Van Brocklin (225) 925-7548	Judy Hitten (207) 624-9678
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?	Yes Yes		Yes No	Yes No
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Yes. Yes		No. Administration of the tax must be in compliance with the tax laws. We do not have the authority to deny a properly due refund or to not enforce the collection of a properly due liability. We can agree to audit the system being used by the taxpayer to determine his liability for accuracy under current auditing methodology, be we can not agree to limit the taxpayer's liability to the amount determined by use of that system.	No
What criteria is used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Business need demonstrated; Large volume of purchases			
Number of SUTCAs in place? Number of SUTCAs pending?	4 in place 0 pending			
General term of SUTCA	Open-ended			
For base period analysis, does agency detail or sample transactions? Who performs analysis?	Sample is performed by the taxpayer with tax authority review/approval			
List accounts specifically excluded from the SUTCA	Purchases for resale; Telecommunications; Construction projects Automobiles; Meals			

Sales and Use Tax Compliance Agreements: Summary of State Practices

	KANSAS	KENTUCKY	LOUISIANA	MAINE
<i>Are local taxes addressed?</i>	Yes. Local taxes imposed at seller's location			
<i>How are significant business changes addressed?</i>	Taxpayer adjusts ratio or rate and maintains supporting documentation for subsequent review by agency.			
<i>How are discrepancies in tax handled?</i>	Require reconciliation of tax			
<i>Additional Comments</i>				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	MARYLAND	MASSACHUSETTS	MICHIGAN	MINNESOTA
Agency Contact	Linda L. Tanton (410) 767-1556		Dale Vettel (517) 373-2746	Larry Wilkie (651) 296-1708
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?	Legal authority not required		Yes Yes	Legal authority not required
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Yes No formal procedures. SUTCAs usually necessitate the taxpayer having a direct pay authority.. The Comptroller's Office is prohibited by law from issuing additional direct pay permits to taxpayers after July 1, 1993. Taxpayers who had been issued direct pay permits prior to July 1, 1993 may still retain their permits.		Yes Pending	Considering.
What criteria is used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases (threshold relative to nature of business); Agreement on sampling procedures		Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases; Computerized records	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer (also requirement for direct pay); Large volume of purchases; Computerized records; Agreement on sampling procedure: TP must be currently under audit audited within the last three year TP's business must be expected to stable for the future payment period. TP must be considered cooperative based on past experience.
Number of SUTCAs in place? Number of SUTCAs pending?	2 in place 0 pending		0 in place 1 pending	0 in place; testing the concept with TPs 0 pending
General term of SUTCA	4 years		5 years	N/A

Sales and Use Tax Compliance Agreements: Summary of State Practices

	MARYLAND	MASSACHUSETTS	MICHIGAN	MINNESOTA
<i>For base period analysis, does agency detail or sample transactions? Who performs analysis?</i>	Sample is performed by the taxpayer with tax authority review/approval		Sample is performed by the taxpayer with tax authority review/approval	Sample performed jointly by the taxpayer and tax authority. Jointly agree on the population from which the sample will be drawn.
<i>List accounts specifically excluded from the SUTCA</i>	Capital assets; Construction projects		Appendix attached to agreement will specify non-qualifying purchases.	Capital assets. No list of types of accounts that would always be excluded. Something that would be decided after seeing how the accounting system was organized, taking into account the type of business/industry that the TP is involved with.
<i>Are local taxes addressed?</i>	No. Local taxes not applicable.		No. No local sales / use taxes in Michigan.	Yes. Imposed at the location in which the first taxable use occurs. This is usually the location where title or possession transfers from the vendor to the customer.
<i>How are significant business changes addressed?</i>	Taxpayer adjusts ratio or rate and maintains supporting documentation for subsequent review by agency.		Either taxpayer or department may request change.	Taxpayer notifies agency; adjustments made going forward. Or, Taxpayer adjusts ratio or rate and maintains supporting documentation for subsequent review by agency.
<i>How are discrepancies in tax handled?</i>	Adjustments made going forward only. Only if taxpayer was in complete compliance with SUTCA agreement. Failure to comply with all aspects of agreement will require reconciliation of tax.		Require reconciliation of tax	Require reconciliation of tax
<i>Additional Comments</i>				We have been working with three taxpayers to test the concept. We have learned that it is much more time consuming on our part as well as the taxpayer's part than was expected.

Sales and Use Tax Compliance Agreements: Summary of State Practices

	MISSISSIPPI	MISSOURI	MONTANA	NEBRASKA
Agency Contact		Carol Fischer (573) 751-3470		G. Shaun Sookram (402) 471-5751
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?		No. Neither Missouri statutes or regulation address this issue. Statute requires taxpayer to remit all taxes due, taxpayers use a variety of methods to calculate tax.	No Sales Tax	Legal authority not required
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?		No No We have considered it in the past, however when we let taxpayers know we would still reserve the right to conduct an audit for past periods and would require payment for any deficiencies found during the audit, the taxpayers usually do not follow up		Considering Pending
What criteria is used to determine whether a SUTCA will be considered?		Taxpayer in good standing; Business need demonstrated; Agreement on sampling procedures; Agreement to audit periods and to pay an deficiencies with interest		Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases; Computerized records; Agreement on sampling procedures
Number of SUTCAs in place? Number of SUTCAs pending?		0 in place 0 pending		0 in place 2 pending
General term of SUTCA		N/A		Has not been finalized; looking at 3 years
For base period analysis, does agency detail or sample transactions? Who performs analysis?		Base period analysis would be performed by taxpayer with tax authority review/approval.		Sample is performed by the taxpay with tax authority review/approval
List accounts specifically excluded from the SUTCA				Capital assets; Construction projects

Sales and Use Tax Compliance Agreements: Summary of State Practices

<i>Are local taxes addressed?</i>		Would require local taxes be handled as statute dictates. (Sales tax for direct pay taxpayers is based on purchaser's location. Otherwise sales tax is based upon the seller's location).		Yes; imposed at purchaser's locatio
<i>How are significant business changes addressed?</i>		N/A		Taxpayer adjusts ratio or rate and maintains supporting documentation for subsequent review by agency.
<i>How are discrepancies in tax handled?</i>		Would require reconciliation of tax		Require reconciliation of tax if bey specified dollar threshold
<i>Additional Comments</i>				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>NEVADA</i>	<i>NEW HAMPSHIRE</i>	<i>NEW JERSEY</i>	<i>NEW MEXICO</i>
Agency Contact			Richard W. Schrader (609) 292-0978	
Does state require legal authority to enter into a SUTCA? Is authority in place?		No Sales Tax	Yes Yes	
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?			Yes No	
What criteria is used to determine whether a SUTCA will be considered?			Taxpayer in good standing; Business need demonstrated; Large volume of purchases (helpful but not mandatory); Computerized records	
Number of SUTCAs in place? Number of SUTCAs pending?			6 in place 3 pending	
General term of SUTCA			3 years	
For base period analysis, does agency detail or sample transactions? Who performs analysis?			Base period analysis may be performed by the taxpayer with tax authority review/approval, or solely by the tax authority	
List accounts specifically excluded from the SUTCA			Purchases for resale; Telecommunications; Utilities	
Are local taxes addressed?			No. No local tax.	
How are significant business changes addressed?			Taxpayer notifies agency; adjustments made going forward.	
How are discrepancies in tax handled?			Agreement provides for no true-ups or refunds	
Additional Comments				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	NEW YORK	NORTH CAROLINA	NORTH DAKOTA	OHIO
Agency Contact	Norman W. Ayers (518) 457-3663	Charles D. Collins, Jr. (919) 733-2151	Gary Anderson (701) 328-3471	William D. Marshall (614) 466-4810
Does state require legal authority to enter into a SUTCA? Is authority in place?	Legal authority not required	Legal authority not required	Legal authority not required	Legal authority not required
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Yes Yes	No. We do not use a SUTCA. We utilize a Memorandum of Understanding (MoU).	No	Yes Yes
What criteria are used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Large volume of purchases (varies); Agreement on sampling procedures; Taxpayers difficulty in making or controlling tax consequences at the time of purchase.	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases; Agreement on sampling procedures		Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases; Computerized records; Agreement on sampling procedure:
Number of SUTCAs in place? Number of SUTCAs pending?	6 in place 8 pending	6 in place with Memorandum of Understanding. 0 pending		15 in place 12 pending
General term of SUTCA	2 years. Each agreement is unique and written based on mutually acceptable terms by the taxpayer and agency.	1-2 years for MoU		3 years. Some taxpayers unfamiliar with direct payment are set up for shorter period (1 - 1 1/2 years) or experience developed and more importantly that we have a data base population to draw a sample that reflects purchases made with direct payment authority
For base period analysis, does agency detail or sample transactions? Who performs analysis?	Base period analysis may be a detail or sample performed by either the taxpayer, the tax authority, or both.	Base period analysis may be a detail or sample. May be performed by the taxpayer with tax authority review/approval, or performed solely by the tax authority.		Base period analysis is a sample (either block or at taxpayer's initiative) may be statistically drawn. May be performed by taxpayer (most cases) or by tax authority (when SUTCA based on prior or ongoing audit)

Sales and Use Tax Compliance Agreements: Summary of State Practices

	NEW YORK	NORTH CAROLINA	NORTH DAKOTA	OHIO
<i>List accounts specifically excluded from the SUTCA</i>	Telecommunications. We recommend exclusion of telecommunications but all other accounts could be included if mutually agreed to.	Capital assets; Purchases for resale; Telecommunications; Utilities; Construction projects		Capital assets (but will consider "mass" assets); Purchases for resale; Utilities; Construction projects; Also may exclude the following at taxpayer discretion: Telecommunications; Corporate procurement card purchases
<i>Are local taxes addressed?</i>	Yes; local taxes are imposed at the purchaser's location. NYS administers both the state and local sales taxes.	Yes; local taxes are imposed at the purchaser's location		Yes; local taxes are imposed at the purchaser's location. To date we have limited single rate reporting direct pay holders. Imposition of tax for them is the point of receipt by the purchaser as well as use (other than storage) in location with higher rate.
<i>How are significant business changes addressed?</i>	Taxpayer notifies agency; adjustments made going forward; OR Taxpayer adjusts ratio or rate ; maintains documentation for subsequent review by tax authority.	Taxpayer notifies agency; adjustments made going forward.		Taxpayer notifies agency; adjustments made going forward.
<i>How are discrepancies in tax handled?</i>	Varies. Each agreement is customized and depending on how the agreement is structured either prospective treatment or true-ups are performed.	Require reconciliation of tax		Require reconciliation of tax. (Assuming this means a subsequent sample reveals a measurable difference between the SUTCA rate used to report and the one resulting from the new sample).
<i>Additional Comments</i>	New York does not have statutory authority to enter into SUTCAs, as such, New York does not actively solicit SUTCAs. We require taxpayers to submit their proposal and we work with them for the mutual benefit of the taxpayer and agency.	Comments provided; will be supplied upon request or a link will be added to the electronic version of this document.		To date we have performed only one follow up audit on a company that used a single rate under agreement with us. It was the first company to use a SUTCA rate. The audit resulted in a need for reconciliation due almost entirely to the enactment of tax on additional services in Ohio that occurred after the rate was first developed.

Sales and Use Tax Compliance Agreements: Summary of State Practices

	OKLAHOMA	OREGON	PENNSYLVANIA	RHODE ISLAND
Agency Contact			John A. May (717) 783-1731	
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?		No Sales Tax	Yes Yes	
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?			Yes Yes	
What criteria is used to determine whether a SUTCA will be considered?			Business need demonstrated; Direct payment permit holder; Large volume of purchases; Agreement on sampling	
Number of SUTCAs in place? Number of SUTCAs pending?			5 in place 4 pending	
General term of SUTCA			3 years	
For base period analysis, does agency detail or sample transactions? Who performs analysis?			Base period analysis is a sample performed either by the taxpayer or the tax authority	
List accounts specifically excluded from the SUTCA			Capital assets; Purchases for resale; Telecommunications; Utilities; Construction projects	
Are local taxes addressed?			Yes; local taxes imposed at purchaser's or seller's location. Because local taxes are imposed at the point of sale a separate factor is computed for the purpose of determining local tax.	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	OKLAHOMA	OREGON	PENNSYLVANIA	RHODE ISLAND
<i>How are significant business changes addressed?</i>			Taxpayer notifies agency; adjustments made going forward.	
<i>How are discrepancies in tax handled?</i>			Adjustments made going forward only	
<i>Additional Comments</i>			The tax authority must be involved with the SUTCA throughout the performance of the field work. After the fact review by the taxing authority results in duplication of efforts and the need for additional records and verification from the taxpayer.	

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>SOUTH CAROLINA</i>	<i>SOUTH DAKOTA</i>	<i>TENNESSEE</i>	<i>TEXAS</i>
Agency Contact	Robert K. Anderson (803) 898-5610	Bruce Christensen (605) 773-3751	Macon J. Dew, Jr. (615) 741-8499	Otis Fields (512) 463-3903
Does state require legal authority to enter into a SUTCA? If yes, is authority in place?	Yes Yes	Yes No	Legal authority not required	Yes Yes
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Yes Yes	No No. South Dakota has not entered into any compliance agreements yet, but we would like to explore the possibility of these agreements in the future.	Yes Pending	Yes Yes
What criteria is used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Business need demonstrated; Direct payment permit holder; Computerized records; Agreement on sampling procedures	Taxpayer in good standing; Business need demonstrated; Perpetually audited taxpayer	Taxpayer in good standing; Direct payment permit holder; Perpetually audited taxpayer	Direct payment permit holder
Number of SUTCAs in place? Number of SUTCAs pending?	1 in place 4 pending		1 in place Several pending	4 in place 6 pending
General term of SUTCA	3 years		3 years	3 years
For base period analysis, does agency detail or sample transactions? Who performs analysis?	Sample performed by the tax authority		Sample performed by the tax authority	Sample performed by the taxpayer with tax authority review/approval
List accounts specifically excluded from the SUTCA	Capital assets; Purchases for resale; Utilities; Construction projects		Capital assets; Purchases for resale; Construction projects	Capital assets (over certain value) Construction projects; Extra-ordinary items
Are local taxes addressed?	Yes; local taxes are imposed at purchaser's location	SUTCAs would include local taxes	Local taxes not addressed within SUTCA.	Yes; local taxes are imposed at the purchaser's location. Purchased tax free with direct pay permit. Local tax due based on location item is removed from inventory.

Sales and Use Tax Compliance Agreements: Summary of State Practices

	<i>SOUTH CAROLINA</i>	<i>SOUTH DAKOTA</i>	<i>TENNESSEE</i>	<i>TEXAS</i>
<i>How are significant business changes addressed?</i>	Addressed on a case by case basis		Taxpayer notifies agency; adjustments made going forward	Taxpayer notifies agency; adjustments made going forward.
<i>How are discrepancies in tax handled?</i>	Require reconciliation of tax		Each agreement could be different; has not been decided	Require reconciliation of tax. If periodic reconciliation determines material difference in reported taxable percentage the state sha have the right to separately asse: the taxpayer or can be subject to refund to the taxpayer, whichever applicable.
<i>Additional Comments</i>		Interested in reviewing the statutes which states have passed providing the legal authority to enter into SUTCA agreements.		This document was completed usin data for percentage based report Texas has also passed legislation that allows for managed audits fo prior period tax compliance. The directives for that program are currently being developed.

Sales and Use Tax Compliance Agreements: Summary of State Practices

	UTAH	VERMONT	VIRGINIA	WASHINGTON
Agency Contact	Craig Sandberg (801) 297-4706		Richard C. Dotson (804-367-8042	Kenneth J. Capek (360) 753-3320
Does state require legal authority to enter into a SUTCA? Is authority in place?	No.		Yes. 58.1-624 on Direct Payment Permits. Legal authority is in place.	Currently examining the feasibility of implementing a program. A report is scheduled for completion during December 1999.
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Agency does not enter into SUTCAs. There is no direct pay authority in Utah law. This would require a participating business to keep track of the various local taxes.		Agency has entered into one or more SUTCAs. Formal procedures are in place.	
What criteria is used to determine whether a SUTCA will be considered?			Taxpayer in good standing; Direct payment permit holder	
Number of SUTCAs in place? Number of SUTCAs pending?			12 in place 0 pending	
General term of SUTCA			3 years	
For base period analysis, does agency detail or sample transactions? Who performs analysis?			Review performed by tax authority	
List accounts specifically excluded from the SUTCA			Capital assets; Purchases for resale; Telecommunications; Utilities	
Are local taxes addressed?			Local taxes are imposed at purchaser's location	
How are significant business changes addressed?			Taxpayer maintains supporting documentation and ratios or rates are adjusted upon subsequent reviews.	
How are discrepancies in tax handled?				
Additional Comments				

Sales and Use Tax Compliance Agreements: Summary of State Practices

	WEST VIRGINIA	WISCONSIN	WYOMING
Agency Contact	Dan Taylor (304) 558-8500	Jean Papenfuss (608) 266-8643	
Does state require legal authority to enter into a SUTCA? Is authority in place?	Legal authority not required	Legal authority not required	
Has agency entered into or considered entering into a SUTCA? If yes, are formal procedures in place?	Yes No	Yes Yes	
What criteria is used to determine whether a SUTCA will be considered?	Taxpayer in good standing; Large volume of purchases; Agreement on sampling procedures	Taxpayer in good standing; Direct payment permit holder; Perpetually audited taxpayer; Large volume of purchases (varies); Computerized records; Agreement on sampling procedures	
Number of SUTCAs in place? Number of SUTCAs pending?	Fewer than 10 in place 1 pending	7 in place 3 pending	
General term of SUTCA	2 years	2 years	
For base period analysis, does agency detail or sample transactions? Who performs analysis?	Sample performed either by the taxpayer or tax authority	Sample performed by tax authority	
List accounts specifically excluded from the SUTCA	Capital assets; Purchases for resale; Utilities; Construction projects	Exclusions are determined on an individual basis	
Are local taxes addressed?	No. No local sales tax is imposed in WV.	Yes. Local taxes are imposed at seller's location	
How are significant business changes addressed?	Taxpayer notifies agency; adjustments made going forward. Possible termination of agreement.	Taxpayer adjusts ratio or rate; maintains supporting documentation for subsequent review by tax agency	

	<i>WEST VIRGINIA</i>	<i>WISCONSIN</i>	<i>WYOMING</i>
<i>How are discrepancies in tax handled?</i>	Handled on a case by case basis within the agreement	Require reconciliation of tax	
<i>Additional Comments</i>		There is a lot of work imposed on the Department of Revenue. We are glad that we did not start out with more than 7 agreements.	

Appendix C

Persons Contributing To This Report

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Appendix D

Summary of Other Task Force Reports

Model Recordkeeping and Retention Regulation is intended to govern taxpayer retention of books and records, particularly electronically generated and retained records, for tax administration purposes. To date, *Alabama, Arizona, California Board of Equalization, Connecticut, Florida, Georgia, Illinois, Iowa, Maryland, New Hampshire, New Jersey, City of New York, South Carolina* and *Utah* have adopted the model regulation in whole or in part.

Auditing Electronic Data provides an overview of the basic framework of the tax audit and examines various issues related to auditing in an electronic environment.

Procurement Cards and Tax Compliance: Bridging the Gap discusses use tax compliance issues associated with corporate procurement cards and examines alternative methods of achieving the appropriate compliance.

Evaluated Receipts Settlement (ERS) and Tax Compliance focuses on understanding the ERS process and identifying potential solutions that would be helpful in addressing the audit and recordkeeping issues created by the use of ERS.

Model Direct Pay Permit Regulation examines the issues involved in the use of “direct pay” permits, a procedure through which certain purchasers are allowed to pay use tax on their purchases directly to the state tax administration agency, rather than to a retailer. The report also contains a model regulation to govern direct pay authority and a survey of state direct pay authority statutes and use.

Editor’s Note: All reports are available from the Federation of Tax Administrators Web site www.taxadmin.org.