

Work Group Report

Exemption Administration

Introduction

This white paper addresses the administration of tax exemptions claimed by purchasers who purchase taxable products and services, e.g., for resale or industrial production, etc. This paper does not address the administration of tax exemptions provided to all purchasers of certain products and services, e.g., food, clothing, and medicines.

Background

Existing sales and use tax systems require purchasers who claim a tax exemption on purchases because of who they are or how they will use the product or service to provide sellers with a "state approved" certificate (or substitute information). The "state approved" certificate (or substitute information) provides the reason for the claimed exemption from tax.

Sellers currently must collect a certificate (or substitute information) from any purchaser who claims a tax exemption because of who the purchaser is or how the purchaser will use the product or service. In most states, sellers must determine if the certificates received from purchasers are offered in good faith. To justify not collecting sales tax sellers must maintain and make available records of all claimed exemptions. Sellers are held liable for the tax if they are not able to produce the required exemption certificates or when a state

determines certificates do not meet the good faith requirement necessary to justify an exemption when sellers determined otherwise.

Having to collect and retain exemption certificates places a substantial administrative burden on sellers. In addition, the current system creates an economic risk for sellers who receive no benefit from the exemptions. Sellers also risk alienating customers when they act on a state's behalf to determine the appropriate use of an exemption certificate.

The current exemption certificate administration process also places a significant administrative burden on taxing authorities to determine if sellers are justified in not collecting sales tax. The audit process for exemption certificates is time consuming.

As our economy shifts more from a local economy to a global economy and from a traditional commerce to electronic commerce, the administrative burdens for both sellers and taxing authorities will grow unless changes are made to simplify the exemption certificate administration process.

Issues

In streamlining the sales and use tax system and simplifying the exemption certificate administration process, the following issues must be addressed:

1. Should purchasers be allowed to claim exemption from tax at the time of purchase of products and services?
2. What information should be required from a purchaser who claims a tax exemption?
3. Should the purchaser's signature be required to claim a tax exemption?
4. Should the information required from a purchaser to claim a tax exemption be standardized for all taxing jurisdictions or does it need to be customized to meet a particular taxing jurisdiction's needs?
5. How should tax exemptions be documented on multiple item orders?
6. Should purchasers be allowed to claim blanket exemptions as they do now or should they be required to file an exemption certificate for every purchase for which they claim a tax exemption?
7. Who should be responsible for determining if a claimed exemption is appropriate?
8. How should eligibility to claim an exemption be verified?

9. When should eligibility to claim an exemption be verified?
10. What records on claimed exemptions should be required to be maintained?
11. Who should be required to maintain records on claimed exemptions?
12. How long should records on claimed tax exemptions be retained?
13. Who should assume the economic risks if the validity of a claimed exemption is challenged?
14. How should taxing authorities discourage misuse and abuse of the exemption certificate administration process?

Research

As first steps toward resolving the issues identified in the previous section of this white paper, the Tax Base and Exemption Administration Work Group:

- Reviewed the exemption certificate administration processes and practices of the participating states;
- Reviewed recommendations proposed by the NTA Project and the Advisory Commission on Electronic Commerce and the Northwest Regional Sales Tax Pilot Project;
- Interviewed software vendors; and
- Gathered input from retailers.

The work group learned that states differ in how they administer their exemption certificate processes. Some states issue taxpayer identification numbers to all persons that are eligible to claim a tax exemption. Other states issue taxpayer identification numbers only to those businesses that are required to collect and remit sales tax. One state issues numbers only to those businesses that are eligible to buy for resale. Many states do not issue taxpayer identification numbers to farmers and exempt entities like charitable organizations.

The work group learned from the recommendations proposed by the NTA Project, the Advisory Commission on Electronic Commerce and the Northwest Project that simplifying and standardizing the exemption certificate administration process is important to overall simplification of the sales and use tax system.

The work group learned from software vendors that a good exemption administration process requires good rules. The software can be designed to calculate tax online; a variety of numbers can be used to identify purchasers; numbers can be validated if desired; and some currently used software programs have exemption processing functionality.

The work group learned from retailers who use electronic certificate processing that electronic exemption certificates make their life easier. Those retailers stated that:

- Paper certificates are fairly costly;
- All states should accept other states' exemption certificates;
- Their software can extract information by type of exemption claimed;
- Compliance may be increased because the exemption certificate is linked to the specific transaction;
- They don't allow blanket certificates due to the added costs don't justify the benefits; and
- They would like all purchasers to have identification numbers to claim an exemption.

Alternatives

The following are the alternatives the Work Group has considered to address the issues mentioned previously.

1. Should purchasers be allowed to claim a tax exemption at the time of purchase of products and services?

We considered two alternatives to address this issue. The first alternative is to continue allowing purchasers to claim a tax exemption at the time of purchase, as they are now able to do. The second alternative is to not allow purchasers to claim a tax exemption at the time of purchase. The second alternative would simplify the seller's exemption certificate administrative process and reduce the sellers' burden. However, denying a purchaser the opportunity to buy tax exempt

could negatively impact many businesses' operations, growth and success. The second option would shift the exemption administrative burden taxing authorities and purchasers. Purchasers making exempt purchases would be required to file a refund claim with the tax authority.

2. What information should be required from a purchaser who claims a tax exemption?

We considered a number of alternatives for addressing this issue. The alternatives ranged from minimal information such as an identification number to detailed information requiring purchasers to explain how they qualify for the exemptions claimed.

3. Should the purchaser's signature be required to claim a tax exemption?

We discussed the purpose for requiring signatures and considered two alternatives for addressing this issue. One was to require an electronic signature and the other was to eliminate the signature requirement. It was mentioned that signatures are currently required to protect sellers. If we shift the responsibility for the tax from the seller to the purchaser, there is less need to require signatures in the future.

4. Should the information required from a purchaser to claim a tax exemption be standardized for all taxing jurisdictions or does it need to be customized to meet a particular taxing jurisdiction's needs?

We considered three alternatives for addressing this issue. The first was to allow states to continue to define their own information requirements for exemption certificates. The second was to standardize all information on exemption certificates. The third was to standardize the form and basic information on the exemption certificate but to allow for some customization to meet a particular taxing jurisdiction's needs.

We also discussed if a universal identification numbering system was necessary for exemption processing and whether or not PIN numbers should be issued to those eligible to claim exemptions.

5. How should tax exemptions be documented on multiple item orders?

We felt the only viable option for addressing this issue was to allow purchasers to claim exemptions on an item by item basis. Otherwise, the purchaser could end up paying too much or too little tax on a multiple item order.

6. Should purchasers be allowed to claim blanket exemptions as they do now or should they be required to file an exemption certificate for every purchase for which they claim a tax exemption?

We felt purchasers should be allowed to claim blanket exemptions as they now are allowed to do.

7. How should eligibility to claim exemption be verified?

We considered two alternatives for addressing this issue. The first was to continue to require the seller to perform this function on behalf of taxing authorities and the second was to shift this responsibility to taxing authorities.

8. How should eligibility to claim an exemption be verified?

We considered verifying eligibility through electronic means. The streamlined system's software could be programmed to verify the identification numbers and

reasons for the exemption against a database of information provided by taxing authorities. We also considered manually verifying eligibility to claim exemptions.

9. When should eligibility to claim an exemption be verified?

We considered two alternatives for addressing this issue – at the time of purchase and at some point in time after the time of purchase. The primary issue surrounding verifying eligibility at the time of purchase is how it can be accomplished without slowing down commerce. A secondary issue is whether this would place unrealistic expectations on taxing authorities to continuously update their databases with information on eligible purchasers.

10. What records on claimed exemptions should be required to be maintained?

We discussed requiring identifying information from the purchasers and their purchases at either the transaction level or at a summary level.

11. Who should be required to maintain records on claimed exemptions?

We considered two alternatives for addressing this issue – the sellers and/or the tax calculation service providers.

12. How long should records on claimed tax exemptions be retained?

We considered two alternatives for addressing this issue. First, we considered establishing a standard statute of limitations and record retention periods that all participating taxing authorities would adopt. Second, we considered allowing taxing authorities to maintain the same statute of limitations and record retention policies they currently have in place.

13. Who should assume the economic risks if the validity of a claimed tax exemption is challenged?

We considered relaxing the good faith requirement and shifting the economic risks for ensuring the validity of an exemption from the seller to the purchaser that claimed the exemption.

14. How should taxing authorities discourage misuse and abuse of the exemption administration process?

We considered requiring an annual eligibility renewal to claim an exemption like expiration the state of Florida's new program. We also considered warning purchasers of the consequences of claiming exemption when not entitled to do so.

Suggested Recommendations

After considering the research findings and discussing the alternatives, the Tax Base and Exemption Administration Work Group feels the following suggested recommendations adequately address exemption certificate administration:

- ◆ Purchasers should continue to be allowed to claim exemption from tax at the time of sale.
- ◆ Purchasers should be required to provide identifying information and the reason for claiming a tax exemption at the time of purchase.
- ◆ It isn't necessary to develop a universal number system to identify purchasers who are eligible to claim exemption from tax.
- ◆ Purchasers should not be required to provide their signature to claim an exemption from tax unless a paper certificate is used.
- ◆ The form used to claim an exemption electronically should have a standard format but can include customized information needed by taxing authorities. The customized information would be limited to the number of exemptions allowed by a taxing jurisdiction and whether or not an identification number would be required. Although some customization would be allowed, the order in which the information is requested would be the same for all taxing

jurisdictions. Specific information that is common on exemption forms, i.e., purchaser name and address, product description and seller name will come from information already in the new system if the exemption is claimed electronically.

- ◆ The good faith requirement for sellers should be relaxed. A seller will be held harmless for the tax if they obtain all information required for a purchaser to claim exemption for tax. However, retailers may be asked to provide additional information on a transaction in the rare event that the purchaser denies claiming exemption or receiving the goods or services purchased to proceed in collecting the tax from the purchaser.

- ◆ Purchasers should be able to claim blanket exemptions as they now are allowed to do.

- ◆ Blanket exemptions must be tied to the retailer and be retailer specific.

- ◆ Purchasers claiming exemption from tax would need to provide the same information whether the sale was made over the Internet, by phone or in person.

- ◆ Eligibility to claim exemption from tax may be verified by taxing authorities at some point in time after the time of purchase. The new system's software will not verify eligibility at the time of purchase.
- ◆ Records on claimed exemptions should be retained for the same period of time as paper records.
- ◆ The tax calculation service provider should be required to maintain the records on claimed exemptions or transmit them electronically to states.

Simplification/Uniformity Benefits of Suggested Recommendations

All sellers regardless of which business and technology model they select will benefit from having a relaxed good faith requirement for accepting exemption claims from purchasers.

All sellers regardless of which business and technology model they select will benefit from not having to verify a purchaser's eligibility to claim exemption from tax.

All sellers regardless of which business and technology model they select will benefit from having standardized exemption claim forms that are accepted by all participating states.

Work Group Report

Bad Debts, Rounding and Sourcing

Principles for a Uniform Bad Debt Deduction

One of the features of a Streamlined Sales and Use Tax System is a uniform provision for compensating vendors for taxes remitted when the purchaser does not pay for the goods or services purchased. The Work Group reviewed the Bad Debt statutes of Arkansas, Florida, Michigan, Minnesota, Ohio, Pennsylvania, Texas, Virginia, Washington and Wyoming, and noted that most had a number of similar characteristics. As a result of the review, the Work Group agreed on a number of criteria a uniform bad debt statute should have.

1. The statute needs to define a bad debt. In accordance with the general provisions of most state statutes, the definition of a bad debt should be tied to the provisions in the Internal Revenue Code (26 U.S.C. 166) that allow a deduction for bad debts. Generally, the statute should specify that the debt has become worthless and uncollectible in order for the vendor to claim a credit. The definition should also specify amounts excluded from the definition of a bad debt. Generally these include interest and finance charges, sales and use taxes paid on the purchase price, uncollectible amounts on property that remains in the possession of the vendor until the price is paid (layaway sales), debt collection expenses, debts sold or assigned to third parties, and the value of repossessed property.

2. There should be a statute of limitations for claiming a bad debt. We recommend that any bad debt deduction or credit be taken within one year of the month in which the taxpayer recognizes the bad debt for federal tax purposes.

3. The statute should provide that a vendor would owe tax on any amounts collected on a bad debt, for which the vendor has taken a bad debt allowance.

4. The statute would provide for a refund of bad debt credit in cases where the credit exceeds the vendor's tax liability.

5. This statute would provide for a deduction from gross sales in the period the debt is deducted. This may not provide an exact match between the tax collected and the allowance given due to possible rate changes. However, the other choice of allowing the amount of tax paid on bad debt sales to be credited against the tax due in the period when the bad debt is claimed was rejected. While this gives a more precise credit of the tax paid by the vendor, it would be more difficult to administer and maintain records.

Information supplied by business representatives at the July 13 meeting indicated a preference for the deduction model, as opposed to the credit model.

One other issue involving bad debt deductions or credits is the mechanics of claiming bad debts in a model where the vendor does not file returns. In such a case, the Certified Service Provider would be filing the return on behalf of the vendor. Presumably, bad debts would not occur on remote sales that are paid for by credit card. The credit card company that authorizes the sale would pay the price and the tax. In a cash sale scenario, the system will have a mechanism for the vendor to process sales and submit the tax to be remitted through the service provider. For bad debts, the service provider would need to credit the bad debt allowance back through the system to the vendor.

Rounding Proposal

The Work Group has determined there is a need for uniform application by states for rounding the tax due on a sale. This was supported by comments we received from sellers who make sales in multiple states having different rounding statutes or rules. Sellers did not specify until our last meeting which statute or rule they preferred only that we develop a uniform application.

States use three different methods for sellers to determine the tax due on a sale when involving a fraction of a cent. Some use a bracket system to determine the tax owed. Others round up to the nearest the cent. Others round up for anything .5 and over and round down for anything .4 and below. Our group is recommending that states adopt the latter method because we feel it is the most acceptable method for consumers who might otherwise feel that the state is

being enriched at their expense. We understand for those states that have a round up rule or statute, this change would have some revenue impact.

States employ different rules for how far sellers are required to carry out the decimal places in determining the tax due. We recommend that it be carried out to three decimal places.

A few states allow taxpayers to round up to the nearest dollar on their tax returns when they report the tax owed. Some sellers have stated this creates a problem because they have to reprogram their computers for a limited amount of states that allow this. Our group recommends that states be allowed to do this.

Sourcing Proposal

This proposal suggests a method to determine which of the jurisdictions involved in a sale (including rentals and licenses)⁴ may impose a sales and use (consumption) tax on or with respect to the sale. The document addresses the concerns of the seller by informing the seller to which jurisdiction the sale pertains and therefore what tax rate(s) and tax base are applicable. The proposal, with one exception for a sale of a product that will be concurrently used in more than one jurisdiction, does not focus on the obligation of a purchaser to self-assess a use tax. This is a destination approach to consumption taxation of remote and other commerce.

⁴ The Sourcing Work Group is developing a definition of a sale. This definition will deal with the issue of whether rentals are sales at the inception of the rental or as each rental payment is made.

The sourcing principle described here presupposes computer processing of information captured by the seller in the ordinary course of its business. The seller's ordinary entries of information in pre-designated fields are captured for determining the appropriate sourcing result mechanically.

Sourcing Principles . Assuming consummation of a sale of a product (regardless of whether the product is characterized as tangible personal property, digital goods or services), a seller will source the sale as follows:

- a) *Over-the-Counter Rule*. When the product is received⁵ by the purchaser at a business location of the seller, the sale is sourced to that business location.
- b) *Ship-to-Customer Rule*. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee) actually occurs, including the location indicated by delivery instructions, known to the seller.
- c) *Established Address Rule*. When a) and b) do not apply, the sale is sourced to the location indicated by an address for the purchaser (or the purchaser's donee) that is available from the business records of the seller that are maintained in the ordinary course of the seller's business.
- d) *Supplied Address Rule*. When a), b), and c) do not apply, the sale is sourced to the location indicated by the address for the purchaser (or the

- purchaser's donee) obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available.
- e) [The Working Group is studying the two alternative approaches stated in this principle.] *Substitute Address Rule*. Where none of the previous rules of a), b), c), or d) apply, including the circumstance where the seller is without sufficient information to apply the previous rules, then the location will be determined by either
- (1) the address from which the intangible was first shipped or the service was primarily provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold, or
 - (2) by the address of the commercial domicile of the seller determined by reference to the aggregate of persons including the seller that would be treated as a single employer under section 52(a) or (b) of the Internal Revenue Code of 1986.
- (f) *Multiple Points of Use Rule*. Notwithstanding the previously stated rules, a business purchaser knowing at the time of its purchase of an intangible or a service that the intangible or service will be concurrently available for use in more than one jurisdiction shall deliver to the seller in conjunction with its purchase a form disclosing this fact ("Multiple Points of Use or MPU" Exemption Form).

⁵ The terms "receive" and "receipt" appearing in this statement of principles contemplates actual

- i. Upon receipt of the MPU Exemption Form, the seller is relieved of all obligation to collect, pay and/or remit the applicable tax and the purchaser shall be obligated to collect, pay, and/or remit the applicable tax on a direct pay basis.
- ii. A purchaser delivering the MPU Exemption Form may use any reasonable, but consistent and uniform, method of apportionment that is supported by the purchaser's business records as they exist at the time of the consummation of the sale.
- iii. The MPU Exemption Form will remain in effect for all future sales by the seller to the purchaser (except as to specific apportionment that is governed by the facts existing at the time of the sale) until it is revoked in writing.

Exceptions: (The sourcing of a consummated sale as provided by these principles is subject to the following special rules:)

- a) A sale of advertising services is sourced to the location where the advertising is in final published form for distribution (disregarding for these purposes any location that merely provides a digital transfer of advertising services).
- b) [Reserved for special rule(s) affecting telecommunications.]

Work Group Report

Business and Technology Models

This document describes the business and technology models envisioned by the states under the Streamlined Sales Tax System. Under that System, the simplification of state and local sales tax laws is combined with the integration of advanced technology into the sales tax collection process to make the seller's sales tax collection burden as low as possible. The System will be available to all sellers, regardless of whether they have nexus with a state.

Under the System, the states assume a large share of the responsibility for sales tax administration. They do this by establishing joint certification standards for both a certified service provider (CSP) and a certified automated system (CAS), by designating qualified entities and systems as a CSP and a CAS, and by providing incentives for the use of a CSP or a CAS. The incentives can be monetary compensation or reductions in liability and audit scope.

A seller can choose to use a CSP or a CAS or can continue its current practices concerning sales tax collection and remittance. Use of a CSP or a CAS is entirely at the discretion of the seller. Use of a CSP or a CAS, however, benefits a seller through reduced liability and audit scope. In general, a seller is not liable for errors resulting from proper use of a CAS and is subject to only a systems check, rather than a traditional audit, on transactions processed with a CAS.

Four business and technology models are envisioned under the Streamlined Sales Tax System. These models are evolving with the development of the System. The vision of the models to date is as follows:

Model 1: Certified Service Provider (CSP) as Agent

Description: Under this model, a seller selects a CSP as an agent to perform all the seller's sales tax functions. The agent then determines the amount of tax due, pays the tax to the states, and files returns with the states using a CAS.

Under the certification process the states are developing, any person that meets the certification standards can be a CSP. The states anticipate that several entities will be able to meet the requirements for a CSP. Consequently, the states expect that a seller that wants to use a CSP will have several from which to make a selection.

The states will compensate a CSP agent on a per transaction basis, a percentage basis, the "float" allowed on amounts collected, or some combination of these methods. The amount is currently unknown because the states do not have enough information on this topic. The value of a significant reduction in liability and audit scope for the seller is also unknown at this time but needs to be considered.

This model is designed for use by sellers that make remote sales and contract with a third party, such as a web hosting service, to perform their order

processing and payment functions. It will work for e-commerce transactions as well as other remote transactions. It will also work for sellers that outsource all of their sales tax administration functions but do not outsource their order processing and payment functions. The automated system of the CSP will be seamlessly integrated into the ordering process. The CSP will integrate its system in the customer ordering process so that the CSP can calculate the tax due, remit the tax to the appropriate state, file a return with the appropriate state, and maintain a record of the transaction.

Liability: The CSP agent in this model is liable for tax due with three exceptions. The exceptions are for properly functioning aspects of the certified automated system, errors by the state, and fraud by the seller. For example, if the states certify an automated system that, at the time of certification, incorrectly calculates the amount of tax due on clothing, the agent is not liable for any tax not collected as a result of this miscalculation because the states made an error in the certification process. Upon discovery of the error, the CSP would have an agreed-upon amount of time to fix the problem so that the correct amount of tax is calculated in the future.

The following items are not included in the three exceptions and the CSP agent is liable for them: failure to remit the amount of tax collected, failure to remit tax on time, failure of the automated system to perform as it was certified to perform,

and failure to correct discovered errors within the time allowed. This is not an exhaustive list of items for which the CSP agent is liable.

The seller in this model is liable for tax due only if the seller commits fraud. The seller must provide the CSP agent with accurate information about the products it sells so that the CSP can accurately determine the tax due on the products.

Failure of the seller to provide accurate information to the CSP that results in liability of the CSP for tax is an issue to be worked out between the CSP and the seller. The states will look to the CSP for the tax due. For example, if a seller gives an inaccurate description of its products to the CSP so that an item that is taxable is considered exempt, the CSP is liable for tax due on the item.

Audit: The CSP agent in this model is subject to audit by the states and to periodic systems checks. Any audit of the seller will be a joint audit performed on behalf of all the states participating in the Streamlined System. The seller in this model is not subject to audit by the states unless the states have reason to believe that the seller is engaged in fraud. A seller remains subject to audit on purchases for its own use by a state in which it has nexus.

Model 2: Seller Uses Certified Automated System

Description: Under this model, a seller selects a certified automated system (CAS) to perform only one part of its sales tax administration functions. That part is the calculation of the amount of tax due on a transaction. This entails a determination of whether an item is taxable, at what rate, and whether the purchaser is exempt from tax. A seller that wants to use a CAS selects among those that are available, establishes an interface with the CAS, and then relies on the CAS to calculate the tax due. An example of this model is the use of a CAS that is on a server and is available for use by numerous sellers. Another example is a CAS that resides on the seller's system.

Use of a CAS benefits both the states and sellers by encouraging a standardized system. The issue of monetary compensation for use of a CAS has not yet been determined. Other incentives, such as a reduced audit scope are envisioned.

Liability: The person who obtained state certification for the CAS used by a seller in this model is liable for failure of the automated system to perform as it was certified to perform and for failure to correct discovered errors within the time allowed. This liability will be set out as a condition of certification. The person is not liable for properly functioning aspects of the certified automated system and errors by the state.

The seller in this model is liable for tax due with two exceptions. The exceptions are failures attributable to the CAS and errors by the state. Thus, the seller is not liable for errors and omissions arising from features of the CAS that the states had certified as being correct. The seller is liable for the accuracy of returns and payments.

Audit: The CAS in this model is subject to a periodic systems check. If the systems check reveals a problem, the CAS will be reviewed and tested further. The seller in this model is not subject to audit on the transactions processed by the CAS unless the states have reason to believe the seller is engaged in fraud. The seller is subject to audit on its tax remittance and return filing functions. The states can check to ensure that all taxes collected have been paid and reported. A seller remains subject to audit on purchases for its own use by a state in which it has nexus.

Model 3: Proprietary System as a Certified Automated System

Description: This model is intended to accommodate large sellers with nationwide sales that have developed their own sophisticated proprietary automated sales tax systems. Under this model, a proprietary system can be certified as a CAS if the system meets the general standards set under Model 1 for tax calculation software, the seller agrees to certain conditions, and the seller meets activity thresholds for multistate sales. The thresholds envisioned are

sales in at least a specified number of states participating in the Streamlined System and sales volume in these states above a specified amount.

A seller that has a proprietary system must agree to several conditions to obtain certification of its system. The seller must agree to process all its sales using the system, to meet a performance standard set by the states for the system, to agree to a methodology for determining whether the system is meeting the established standard, and to allow the states to periodically examine the system to determine if the system is meeting the established standard.

When the states review a proprietary system for the purpose of certifying the proprietary system as a CAS, the states will establish a performance standard for that system. The performance standard set for a proprietary system may be raised in the future based on a decrease in the difficulty of tax compliance or another factor. The performance standard will include a statistical confidence level and an acceptable margin of error. The states must be X% confident that the true error rate of the system is less than X% on all tax collected.

After a seller agrees to the conditions, the seller and the states will agree to a start date for entry into the Streamlined Project. The seller's system will then be periodically measured against the standard. If the system falls short of the standard, the seller is liable for tax attributable to the shortfall.

The states or a seller can measure the seller's system before the start date, but it is not necessary. The seller is agreeing to perform at a specified level and a subsequent test will determine if the seller is meeting that standard. Entry into the Project will therefore not be impeded by any lack of state resources to perform the measurements.

Liability: In this model, the seller is acting as its own CSP and is therefore accountable for all the sales tax functions. The seller is liable for tax due with two exceptions. The exceptions are for proper functioning of the seller's system within the performance standard set for the system and errors by the state. The seller is liable to the extent the system does not meet the performance standard and is liable for taxes collected but not remitted, the failure to pay tax on time, and the failure to correct discovered errors within a time agreed upon by the states and the seller. The seller is liable, of course, for use tax due a state in which it has nexus.

As stated, a seller in this Model is liable to the extent its proprietary system does not meet the performance standard established for the system. To illustrate this, assume the standard for the proprietary system is 95% confidence that the true error rate of the system is less than 2% on all tax collected and that the true error rate of the system was determined to be 2.2%. Assume further that all 46 sales tax states were participating in the Streamlined System during the tax period, that the Seller had sales in the 46 states for that period of \$500 million, and that the

overall rate for that period was 6%. The seller in this example is liable for a total underpayment of tax to all the states of \$60,000 (\$500 million x .002 x .06). It is envisioned that the states will adopt a tiered penalty structure for these underpayments so that no penalties are imposed for slight failures to meet the established standard and increasing penalties are imposed for larger failures.

Audit: The seller in this Model is subject to a periodic check of its proprietary system. If the system check reveals a problem, the system may be reviewed and tested further.

The seller in this Model is subject to audit to ensure that all taxes collected have been remitted and that all use taxes owed on purchases have been paid. A seller is also subject to audit when the states have a reasonable suspicion that the seller has committed fraud or otherwise engaged in unlawful conduct. Any audit of the seller will be a joint audit performed on behalf of all the states participating in the Streamlined System.

Model 4: Current Practice

This model is the current practice of sellers. As stated earlier, the decision of whether to use a CSP or a CAS is entirely up to the seller. Sellers that do not find the use of a CSP or a CAS relevant or beneficial to their circumstances can continue to calculate, pay, and report sales tax under their current procedures.

These sellers will nevertheless benefit from uniform legislation achieved by the Streamlined Sales Tax System and other simplification efforts.

The Streamlined Sales Tax System will provide a uniform, simplified, and efficient tax system for the participating states. It will eliminate the current patchwork of state sales tax laws, which creates a complex and costly environment for businesses and consumers alike. By adopting the Streamlined Sales Tax System, participating states will ensure that their sales tax laws are consistent with those of their neighbors, thereby reducing the burden on businesses and consumers. This will result in a more competitive and efficient marketplace, which will benefit all participating states.

The Streamlined Sales Tax System will also provide a significant source of revenue for participating states. It will ensure that all participating states receive a fair and equitable share of the tax revenue generated by the system. This will help to ensure the long-term financial stability of participating states and their ability to provide high-quality public services to their citizens.

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Administration of Streamlined Sales Tax System

States will implement the Streamlined Sales Tax System through enactment of uniform provisions. These uniform provisions will include selected features of sales tax law and joint operational authority specifically necessary to accomplish the purposes of the Streamlined System. Those provisions will not include those features of sales tax law that will continue to vary among the States.

To participate in the Streamlined System, States must enact the uniform provisions in identical or "substantially similar" form. If a State's enactment is not identical, then all of the other States must agree that the language used by that State is "substantially similar" to the provisions enacted by the other States. One of the uniform provisions will provide for the designation of representatives of each State to exercise decision-making with respect to these issues.

One of the uniform provisions will delegate authority and responsibility to an appropriate executive branch official to enter into joint administrative agreements with other participating States. Those joint administrative agreements will implement those features of the Streamlined System that require joint administrative operations among the States.