



COUNSEL'S CORNER

SALES AND USE TAX

DOES GOOD FAITH MATTER? How the Streamlined Sales & Use Tax Agreement Has Relaxed the Burden on Retailers Accepting Resale Certificates

Erica L. Horn, Esq.

Stoll Keenon Ogden PLLC

Lexington, KY

Phone: (859) 231-3037

E-mail: erica.horn@skofirm.com

Maddie Schueler, Esq.

Stoll Keenon Ogden PLLC

Lexington, KY

Phone: (859) 231-3967

E-mail: madonna.schueler@skofirm.com

The Streamlined Sales Tax Project began in March 2000 as an effort to create more uniformity in state sales and use tax systems.¹ The Project resulted in the adoption of the Streamlined Sales and Use Tax Agreement (“Agreement” or “SSUTA”) on November 12, 2002.² Today, twenty-two states have fully adopted the

¹ Streamlined Sales Tax Governing Board, Inc., “About Us,” <http://www.streamlinedsalestax.org/index.php?page=About-Us>.

² Streamlined Sales and Use Tax Agreement, available at <http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%205-24-12.pdf>.

Agreement.³ Two other states are considered “associate members,” meaning these states have achieved substantial compliance with the Agreement as a whole, although not necessarily with each provision.⁴ Since its adoption in 2002 until it was last amended on May 24, 2012, the Agreement has been amended at least once per year.⁵ One area that has evolved as a result of the Agreement is the burden on a seller of tangible personal property when accepting a resale certificate from a purchaser. In Kentucky, for example, this evolution is apparent in the changing definition of “good faith” in connection with the duty of a seller receiving a resale certificate.

Background

Under Kentucky law, all gross receipts from the sale of tangible personal property and digital property are presumed to be subject to tax.⁶ There is an exception, however, as in most states, for gross receipts from “any sale for resale.”⁷ Kentucky law shifts the burden of proving a sale is for resale from the retailer to the purchaser *if* the retailer obtains a resale certificate and follows other guidelines set forth by statute.⁸ Prior to July 1, 2011, Kentucky law relieved the seller from sales and use tax *only if* the seller took the resale certificate from the purchaser in “good faith.” Kentucky’s definition of “good faith” has evolved over time to be consistent with

³ The following states have fully adopted the Agreement: Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. Streamlined Sales Tax Governing Board, Inc., “State Info,” <http://www.streamlinedsalestax.org/index.php?page=state-info>.

⁴ Ohio and Tennessee are associate members. *Id.*

⁵ See SSUTA.

⁶ KRS § 139.260.

⁷ KRS § 139.010(25).

⁸ See KRS § 139.270. The contents and form of the resale certificate are described in KRS § 139.280, which requires that the resale certificate “(a) Be signed by and bear the name and address of the purchaser; (b) Indicate the number of the permit issued to the purchaser; (c) Indicate the general character of the tangible personal property or digital property sold by the purchaser in the regular course of business.” KRS § 139.280(1).

(Continued on page 6)

the Agreement.⁹ In 2011, Kentucky removed the “good faith” requirement entirely, following the recent trend set forth by the Agreement to place the burden of taxation on the purchaser whose use of the purchased goods does not comply with the resale certificate.

Pre-SSUTA: Kentucky’s “Good Faith” Standard from 1982 to June 30, 2004

In 1982, Kentucky’s General Assembly amended KRS § 139.270, Kentucky’s statute addressing resale certificates and certificates of exemption, to include the following description of “good faith”: “Good faith on the part of the seller shall be demonstrated by the seller **determining** that the kind of property being sold to the purchaser is normally offered for resale in the type of business operated by the purchaser”¹⁰ Thus, prior to Kentucky’s adoption of the Agreement, Kentucky imposed upon the seller an affirmative “duty of inquiry” regarding the kind of property being sold and the nature of the purchaser’s business. This “duty of inquiry” remained part of KRS § 139.270 until 2004 when the General Assembly first amended Kentucky’s sales and use tax statutes to conform to the Agreement.¹¹

The First SSUTA Changes: Elimination of the “Duty to Inquire” Effective July 1, 2004

The General Assembly amended KRS § 139.270 to remove the “duty to inquire,” making Kentucky’s definition of “good faith” consistent with the Agreement, effective July 1, 2004.¹² Accordingly, a resale certificate relieved the seller from the burden of proof “only if taken in good

faith” at the time the property was purchased.¹³ However, a seller satisfied the “good faith” requirement by doing only two things: “accept[ing] a properly completed resale certificate” and “maintain[ing] a file of the certificate in accordance with KRS § 139.270.”¹⁴ The elimination of the “duty to inquire” was Kentucky’s first step in relaxing the “good faith” standard.¹⁵

SSUTA Changes Continued: July 1, 2007

The General Assembly amended KRS § 139.270 again, effective July 1, 2007.¹⁶ Although, again, the resale certificate relieved the seller of the burden of proof “only if taken in good faith,” the General Assembly added a new twist.¹⁷ Good faith was demonstrated by the seller if the seller: “1. Accept[ed], within ninety (90) days subsequent to the date of sale, a properly completed resale certificate . . . ; and 2. Maintain[ed] a file of the certificate or data elements in accordance with KRS 139.720.”¹⁸ The General Assembly also added a new subsection, section (3)(b), which provided:

If the retailer or seller has not obtained an exemption certificate or resale certificate or all relevant data elements within ninety (90) days subsequent to the date of sale, in keeping with the good faith standard, the seller or retailer may offer additional documentation to the department [of revenue] that the transaction is not subject to tax after the ninety (90) day period which the department may consider.¹⁹

The codification of this “grace period” in 2007 appears to reflect an understanding on the part of the General Assembly of the realities of doing business. Like other changes to the “good faith” standard after 2004, subsection (3)(b) works in favor of retailers.

⁹ Kentucky became a full member of the Streamlined Sales Tax Project on October 1, 2005. Streamlined Sales Tax Governing Board, Inc., “Kentucky,” <http://revenue.ky.gov/business/salesanduse.htm>.

¹⁰ 1982 Ky. Acts ch. 208, § 1 (emphasis added).

¹¹ Prior to the 2004 revision in the definition of “good faith,” both the Kentucky Board of Tax Appeals (“KBTA”) and Kentucky courts held retailers responsible for sales tax for failing to make the required inquiry. See, e.g., *Department of Revenue v. Warren Chemical & Janitor Supply Company*, 562 S.W.2d 644 (Ky. App. 1977)(sales by a manufacturer of weed killer to a funeral home and toilet bowl cleaner to the Kentucky State Police evidenced a lack of good faith) and *Cady Auction Co., Inc. v. Department of Revenue*, KBTA, File No. K79-R-11 (June 4, 1981) (auction company did not take resale certificates in good faith when it sold non-baking equipment to a bakery and weed-eaters to a radio communications service).

¹² 2003 Ky. Acts ch. 124, § 14.

¹³ KRS § 139.270(1)(eff. 7-1-2004).

¹⁴ *Id.*

¹⁵ Whether the Kentucky Department of Revenue understands and will abide by the direction of the General Assembly remains to be seen.

¹⁶ 2007 Ky. Acts ch. 141, § 7.

¹⁷ *Id.*

¹⁸ KRS § 139.270(3)(a) (eff. 7-1-2007).

¹⁹ *Id.* (3)(b).

(Continued on page 7)

Kentucky's Current Statute: Elimination of the Phrase "Good Faith" Effective July 1, 2011

The most recent changes to KRS § 139.270 took effect on July 1, 2011.²⁰ These changes included: (1) the complete elimination of the phrase "good faith," and (2) codification of an additional 120-day period during the actual audit process for retailers to produce a fully completed resale or exemption certificate or other information establishing that the transaction was not subject to tax.²¹ The relevant sections of KRS § 139.270 now provide:

(1) The resale certificate, certificate of exemption, or Streamlined Sales and Use Tax Agreement Certificate of Exemption relieves the retailer or seller from the burden of proof if the retailer or seller:

(a) Within ninety (90) days after the date of sale:

1. Obtains a fully completed resale certificate, certificate of exemption, or Streamlined Sales and Use Tax Agreement Certificate of Exemption; or
2. Captures the relevant data elements that correspond to the information that the purchaser would otherwise provide to the retailer or seller on the Streamlined Sales and Use Tax Agreement Certificate of Exemption; and

(b) Maintains a file of the certificate obtained or relevant data elements captured in accordance with KRS 139.720.

* * *

(3) (a) If the department requests that the seller or retailer substantiate that the sale was a sale for resale or an exempt sale and the retailer or seller has not complied with subsection (1) of this section, the seller or retailer shall be relieved of any liability for the tax on the transaction if the seller or retailer, within one hundred twenty (120) days of the department's request:

1. Obtains a fully completed resale certificate, exemption certificate, or Streamlined Sales and Use Tax Agreement Certificate of Exemption from the purchaser for an exemption that:

- a. Was available under this chapter on the date the transaction occurred;
 - b. Could be applicable to the item being purchased; and
 - c. Is reasonable for the purchaser's type of business; or
2. Obtains other information establishing that the transaction was not subject to the tax.
- (b) Notwithstanding paragraph (a) of this subsection, if the department discovers through the audit process that the seller or retailer had knowledge or had reason to know at the time the information was provided that the information relating to the exemption claimed was materially false, or the seller or retailer otherwise knowingly participated in activity intended to purposefully evade the tax that is properly due on the transaction, the seller or retailer shall not be relieved of the tax on the transaction. The department shall bear the burden of proof that the seller or retailer had knowledge or had reason to know at the time the information was provided that the information was materially false.

* * *

(4) Notwithstanding subsections (1) and (3) of this section, the seller or retailer may still offer additional documentation that is acceptable by the department that the transaction is not subject to tax and to relieve the seller or retailer from the tax liability.²²

The most recent amendments to KRS § 139.270 mirror the 2009 amendments to Section 317 of the Agreement, with one exception. Note that the Agreement retains the phrase "good faith" in connection with the 120-day period granted retailers to obtain a fully completed certificate. Under Section 317, a retailer obtains a fully completed exemption certificate in good faith if the certificate "claims an exemption that (i) was statutorily available on the date of the transaction in the jurisdiction where the transaction is sourced, (ii) could be applicable to the item being pur-

²² KRS §§ 139.270(1), (3) and (4), effective July 1, 2011.

²⁰ 2011 Ky. Acts ch. 33, § 4.

²¹ *Id.*

(Continued on page 7)

chased, and (iii) is reasonable for the purchaser's type of business."²³

Despite this remaining use of "good faith," the 2009 amendments to Section 317 of the Agreement (and the corresponding changes to KRS § 139.270) reinforce the recent trend that, in the absence of fraud, a retailer accepting a resale certificate will be relieved of liability for collecting sales tax, and the state must pursue purchasers providing inaccurate certificates.

A Sample of Other SSUTA States

Other states adhering to the Agreement also have revised their laws pertaining to resale and exemption certificates to achieve compliance with the Agreement's provisions. For example, in 2006, West Virginia addressed the 90-day period in the Agreement by adding a provision to its Code section relating to the administration of exemptions.²⁴ Since 2006, West Virginia law has provided that a seller obtaining a fully completed exemption certificate or capturing the relevant data elements required under the Agreement within 90 days of the date of sale is relieved of paying tax on the transaction.²⁵ West Virginia also added a provision in 2006 granting a seller 120 days subsequent to a request by the Tax Commissioner to either prove the transaction was not subject to tax or obtain in good faith a fully completed exemption certificate from the purchaser.²⁶

In 2009, Wisconsin made similar changes to its Administrative Code. Wisconsin removed the "good faith" requirement if a seller obtains a fully completed exemption certificate from the purchaser within 90 days of the date of sale.²⁷ That same year, Wisconsin added a provision allowing a seller 120 days after the Department of Revenue

²³ SSUTA § 317(D) (amended 2009), available at <http://www.streamlinedsalestax.org/uploads/downloads/SSUTA%20Amendments/2009/AM09017A01%20Section%20317%20amendment-good%20faith.pdf> (language added in 2009 is emphasized).

²⁴ W. Va. Code § 11-15B-24, *Notes: Effect of amendment of 2006* (stating that Acts 2006, c. 234, eff. 6-7-06, added subsections (c) and (d) to § 11-15B-24, which address the time within which a seller must obtain exemption certificates).

²⁵ W. Va. Code § 11-15B-24(c).

²⁶ *Id.* (d)(1).

²⁷ Wis. Admin. Code Tax § 11.14, *Note* (stating "[t]he removal of the good faith requirement if a fully completed exemption certificate is obtained by the seller from the purchaser within 90 days of the date of sale became effective October 1, 2009, pursuant to 2009 Wis. Act 2").

requests an exemption certificate to obtain an exemption certificate or otherwise prove a transaction is exempt.²⁸

Michigan grants retailers even greater leeway. Since 2009, Michigan law has provided sellers with 120 days after the date of sale to obtain a fully completed exemption form or capture the relevant data elements in the form in order to avoid tax on the transaction.²⁹ If a seller fails to obtain an exemption form or all relevant data elements within 120 days after the sale, Michigan allows the seller to prove the transaction was not subject to tax by other means or obtain a fully completed exemption form by the later of:

- (a) 120 days after a request by the department.
- (b) The date an assessment becomes final.
- (c) The denial of a claim for refund.
- (d) In the instance of a credit audit, the issuance of an audit determination letter or informal conference decision and order of determination.
- (e) The date of a final order of the court of claims or the Michigan tax tribunal, as applicable, with respect to an assessment, order, or decision of the department.³⁰

Like Kentucky has done, West Virginia, Wisconsin, and Michigan have relaxed the burden on retailers accepting resale certificates to comply with the Agreement, albeit to varying degrees.

Conclusion

Kentucky and other states adopting the Agreement appear to have shifted their focus from retailers accepting invalid resale certificates to purchasers whose use of the purchased goods does not comply with the certificate.

²⁸ *Id.* (stating "[t]he requirement that a seller is allowed 120 days after the Department of Revenue requests that they obtain an exemption certificate or otherwise prove that a transaction is exempt became effective October 1, 2009, pursuant to 2009 Wis. Act 2").

²⁹ Mich. Comp. Laws § 205.62, *Notes: The 2008 amendment* (stating that the 2008 amendment to § 205.62 (Pub Acts 2008, No. 438, eff. 1-9-09) added subsection (6), which provides that "[a] seller who obtains a fully completed exemption form or captures the relevant data elements as outlined in this section within 120 days after the date of sale is not liable for the tax").

³⁰ Mich. Comp. Laws § 205.62(7).

(Continued on page 9)

The 2009 amendments to the Agreement reinforce the idea that, absent fraud, a retailer accepting an ultimately invalid resale certificate should not be held liable for the tax. This shifting focus should be a welcome change for retailers who undoubtedly find it difficult to determine whether a purchaser plans to use the purchased goods in accordance with the resale certificate provided. States adopting this recent trend rightfully place the burden of taxation on the responsible party: the purchaser using the goods in a non-exempt manner.