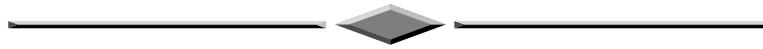


# ADMINISTRATION & ACCOUNTING



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# **EXEMPTION CERTIFICATES**

## **INTRODUCTION**

This section deals with the audit methods and procedures to be utilized when dealing with acceptance of exemption certificates. **KRS 139.490 - Purchaser's Liability for Using Property in Other than Exempt Way after Certification** and **KRS 139.430 - Property Used by Purchaser after Giving Certificate** and **KRS 139.270 - Resale Certificate or Certificate of Exemption** deal with this issue.

## **KRS 139.490 - Purchaser's Liability for Using Property in Other Than Exempt Way after Certification**

**139.490 Purchaser's liability for using property in other than exempt way after certification.** (Effective until July 1, 2004)

If a purchaser certifies in writing to a seller that the property purchased will be used in a manner or for a purpose entitling the seller to exclude from the computation of the sales tax the gross receipts from the sale and uses the property in some other manner or for some other purpose, the purchaser, not the seller, shall be liable for payment of sales tax as if he were a retailer making a retail sale of the property at the time of such use, and the cost of the property to him shall be deemed the gross receipts from such retail sale. The certificate of exemption relieves the seller from the sales and use tax only if he takes the certificate in good faith from the purchaser. Good faith shall be demonstrated by the seller if he accepts a signed certificate and maintains a file of such certificate in accordance with KRS 139.720. If the cabinet later finds that the purchaser used the property in a manner that would not have qualified for tax exempt status, the cabinet shall hold the purchaser liable for the remittance of the tax and may apply any penalties as provided in KRS 139.990.

**Effective:** July 15, 1988

**History:** Amended 1988 Ky. Acts ch. 135, sec. 5, effective July 15, 1988. -- Amended 1982 Ky. Acts ch. 102, sec. 1, effective July 15, 1982. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 49, effective February 5, 1960.

This statute was repealed effective 7/1/04, due to duplication of language in **KRS 139.430**.

## **KRS 139.430 – Property Used by Purchaser after Giving Certificate**

### **139.430 Property used by purchaser after giving certificate.**

If a purchaser who gives a certificate makes any storage or use of the property other than retention, demonstration or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used. If the sole use of the property, other than retention, demonstration or display in the regular course of business, is the rental of the property while holding it for sale, the purchaser shall pay the tax on the use measured by the amount of the rental charged rather than the sales price of the property to him.

**Effective:** August 1, 1985

**History:** Amended 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 9, effective August 1, 1985. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 42, effective February 5, 1960.

**Legislative Research Commission Note.** 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 11, directed that the provisions of this section would be effective August 1, 1985.

## **KRS 139.270 – Resale Certificate or Certificate of Exemption**

- (1) The resale certificate or certificate of exemption relieves the retailer or seller from the burden of proof only if taken in good faith from a person who, at the time of purchasing the tangible personal property:
  - (a) Indicates an intention to sell it in the regular course of business by executing the resale certificate; or
  - (b) Indicates that the property purchased will be used in an exempt manner by executing a certificate of exemption.This relief from liability does not apply to a retailer or seller who fraudulently fails to collect the tax or solicits purchasers to participate in the unlawful claiming of an exemption.
- (2) "Good faith" shall be demonstrated by the retailer or seller if the retailer or seller:
  - (a) Accepts a properly completed resale certificate or certificate of exemption; and
  - (b) Maintains a file of the certificate in accordance with KRS 139.720.
- (3) If the department later finds that the retailer or seller exercised good faith according to the provisions of subsection (2) of this section but that the purchaser used the property in a manner that would not have qualified for resale status or the purchaser issued a certificate of exemption and used the property in some other manner or for some other purpose, the department shall hold the purchaser liable for the remittance of the tax and may apply penalties provided in KRS 139.990.

**Effective:** June 20, 2005

**History:** Amended 2005 Ky. Acts ch. 85, sec. 414, effective June 20, 2005. -- Amended 2003 Ky. Acts ch. 124, sec. 14, effective July 1, 2004. -- Amended 1988 Ky. Acts ch. 135, sec. 2, effective July 15, 1988. -- Amended 1982 Ky. Acts ch. 208, sec. 1, effective July 15, 1982. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 27, effective February 5, 1960.

## **GENERAL INFORMATION**

The seller of tangible personal property will not include within the measure of his tax the gross receipts from a retail sale if he takes from the purchaser a "certificate of exemption" that the property purchased will be used in a manner or for a purpose entitling the seller to regard the gross receipts from the sales as exempt under the Sales and Use Tax Law.

The "certificate of exemption" relieves the seller from the sales and use tax only if he takes the certificate in **good faith** from the purchaser at the time of sale. Good faith shall be demonstrated by the seller if he accepts a signed certificate and maintains a file of such certificate in accordance with **KRS 139.720**. If the Department later finds that the purchaser used the property in a manner that would not have qualified for tax exempt status, the Department shall hold the purchaser liable for the remittance of the tax and may apply any penalties as provided in **KRS 139.990**.

In order to obtain the benefits of any of the sales tax exemptions, i.e. farm machinery, etc., the purchaser claiming the exempt status must issue to the seller the required certificate substantiating the exemption. The statute contains, and has contained for many years, the requirement that the seller (vendor) is relieved from liability only if he takes the certificate from the purchaser in "**Good faith**". Although the statute or regulations have not always contained a definition of "Good faith" an addition to **KRS 139.490** by the 1982 General Assembly effectively restricted this avenue of assessment against the seller and shifted the Department's responsibility to secure compliance from the numerous purchasers who have issued invalid exemption certificates. "Good faith" is currently defined as accepting a signed certificate at the time of sale and maintaining a file of those certificates.

Concisely stated, current procedure mandates that if a vendor has a certificate on file that is entirely complete, signed and dated and the certificate being issued applies to the purchaser's business, then such certificate will be honored. Additionally, the certificate will be honored if the **property** is applicable to the purchaser's type of business.

As far as legislative changes as a result of Streamlined Sales and Use Tax Agreement, the language in **KRS 139.270** basically reinforces the prevailing intent of the General Assembly.

In a related matter, the question of "**Good faith**" has been addressed in a case styled **Whayne Supply Company v. Revenue Cabinet**, K02-R-40.

At issue were three exemption certificates the taxpayer-seller had received in connection with Kentucky retail sales. Under **KRS 139.490**, a seller is relieved of liability for sales and use tax if it accepts in good faith from a purchaser a written certificate that the property purchased will be used in a tax-exempt manner or for a tax-exempt purpose and maintains a file of these certificates in accordance with **KRS 139.720**.

In this case, the KBTA granted summary judgment in the Department's favor, ruling that the three certificates "were either incomplete or obviously invalidly completed, and none [met] the threshold requirement of **KRS 139.490** for a written statement that the property will be used in a

manner/purpose that makes the sale exempt from tax.” For example, one of the certificates, purporting to rely upon the exemption for machinery for new and expanded industry, stated that the machinery or equipment in question was going to West Virginia for installation, a circumstance that on its face precluded the application of that exemption. See Kentucky Administrative **Regulation 103 KAR 30:120§1(4)**. A seller that accepts an incomplete certificate or an obviously invalid certificate is not entitled to protection from sales tax liability, the KBTA ruled.

## **AUDIT PROCEDURE - VENDOR**

### **Verify Deductions Taken are Substantiated by Certificates of Exemption**

Sales invoices should be examined to determine that the claimed amounts are included in total sales and that the correct amounts have been scheduled. Verify that the deduction on the return is correct by ensuring that amounts claimed do not include nontaxable items such as labor that should be claimed under some other classification, and that no part of the invoice represents a taxable sale.

If the taxpayer cannot support the claimed deduction, then such deduction must be disallowed.

### **Verify Acceptability of Documentary Evidence Supporting Deduction - Good Faith**

All claimed sales deemed exempt by virtue of being supported by a certificate of exemption will be allowed if such certificate is proper in form and taken in good faith from the purchaser at the time of sale. “Good faith” is defined as accepting a signed certificate and maintaining a file of those certificates. If a vendor has a certificate on file that is entirely complete, signed and dated and the property being purchased applies to the purchaser's type of business, then such certificate will be honored.

Prior to 7/1/04, the law defined good faith for the acceptance of certificates of exemption differently from that for the acceptance of resale certificates but effective 7/1/04, both resale and exemption certificates are treated substantially the same.

Many occasions exist when the retailers fail to obtain the proper certificate at the time of making the sale. In an attempt to administer the sales and use tax law in a fair manner and to collect only those taxes due, the Department has permitted the taxpayer a grace period in which it can obtain certificates after the audit process begins. However, it must be understood that exemption certificates obtained during this grace period have not been accepted in “Good faith” as required by **KRS 139.490** and **KRS 139.270**. Accordingly, such certificates are subject to more scrutiny than those certificates obtained at the time of sale and retained on file.

Certificates of Exemption obtained by a retailer after audit for items which are **clearly taxable (no exemption exist)** are not valid and do not relieve the retailer from the tax liability. A seller that fails to obtain the certificate at the time of sale has failed to show good faith by obtaining the required certificate and maintaining the file as required by **KRS 139.490** and **KRS 139.270**.

The auditor/reviewer has the responsibility of examining the certificates of exemption and must be reasonable, fair-minded and use good judgment in determining whether the certificate is sufficient in content and whether the seller acted in good faith in accepting the certificates.

A seller will be held responsible for the tax when the exemption certificate does not apply to the purchaser's business or the property acquired is not applicable to the purchaser's type of business. Examples of transactions which should be questioned include:

- ◆ Seller accepts from a restaurant a purchase exemption certificate which is to be used only by exempt organizations such as resident, nonprofit, educational, charitable and religious institutions.
- ◆ Seller accepts a certificate of exemption for machinery for new and expanded industry from an auto manufacturer for the purchase of a set of golf clubs.

### **Purchase Exemption Certificate – Revenue Form 51A126**

This certificate is a statement signed by the purchaser to the effect that the property purchased will be solely within the exempt function of the nonprofit institution. Only Kentucky resident **501(c)(3)** nonprofit charitable, educational and religious institutions, holding a purchase exemption number from the Department of Revenue, are authorized to issue the purchase exemption certificate. See **KRS 139.495**.

Since **KRS 139.495** is limited to purchases made directly by the exempt entity, a retailer cannot accept a purchase exemption certificate from an employee or member of the exempt organization for purchases paid for by such person using his/her own funds. Retailers obtaining purchase exemption certificates in such situations will be held liable for the tax.

“Good faith” is not present when the exemption certificate accepted from the purchaser does not apply to the purchaser’s type of business or organization. For example, a retailer cannot claim “Good faith” if he accepts a purchase exemption certificate from:

- ◆ A plumbing business.
- ◆ A religious organization for the purchase of gaming equipment. This type property would not be for use in a religious function; therefore, the exemption afforded by **KRS 139.495** would not apply.

### **Exemption of Educational, Charitable and Religious Organizations**

In some instances, qualifying organizations, especially churches, will apply for an exemption authorization after many years of existence. This leads to the question about refunds of tax paid prior to the issuance of the authorization. It is the Department’s position that since the statute (**KRS 139.495**) provides the exemption, it is effective at the time the organization comes into existence and that the organization is entitled to a refund of any tax paid prior to obtaining a formal exemption authorization which itself is merely an administrative procedure. Some judgment will need to be

used where it is obvious that the property was sold to a qualified institution. If the vendor can verify that a church, school or charitable organization paid for the property, then acquiring a certificate is merely academic. In the absence of a certificate, it is the responsibility of the seller to prove the exemption. However, the auditor should not knowingly tax a sale that is known to be exempt merely because of the absence of an exemption certificate. See **Section K** of Part I for additional information.

### **Exemption of Sales to Governmental Units**

The use of the purchase exemption certificate is limited to institutions qualifying for **IRC Section 501(c)(3)**. Accordingly, such certificates are not to be honored for sales to units of local government or sales to the Federal government. **KRS 139.470(7)** and **Regulation 103 KAR 30:235** provide that an official of the governmental unit is to acknowledge the government's use of the property on a copy of the sales invoice and the seller is to retain the acknowledged copy. A governmental entity should issue a copy of their purchase exemption authorization letter to their vendors.

In a related matter, **KRS 139.470(10)** provides an exemption for out-of-state agencies, organizations and institutions under certain conditions. **Form 51A127 - Out-of-State Exemption Certificate** can be used to support this exemption. See **Section J** in of Part I for additional information.

### **Farming Exemption Certificates**

#### **Revenue Form 51A158 - Farm Exemption Certificate**

#### **Revenue Form 51A159 - On-Farm Facilities Certificate of Exemption for Materials, Machinery & Equipment**

In regard to the acceptance of the **51A158**, the same requirements of good faith are imposed as for the Purchase Exemption Certificate. The retailer needs only to compare the box checked on the certificate with the property purchased to determine if the purchaser is entitled to the exemption. However, when a retailer accepts from a farmer **Revenue Form 51A158** and the property purchased is not of the kind identified on the certificate as being exempt from the tax, the retailer is not relieved of the responsibility for the appropriate amount of tax due on the sale. These two exemption forms (**51A158** and **51A159**) combined and replaced several older forms that may still exist in vendors' files. These outdated forms are listed by asterisks in the table at the end of this article. These outdated forms should still be honored if accepted in good faith and still on file for qualified items. However, because the revised forms do not include the SS# of the farmer, a new form must be completed and maintained on file. The exemptions have not changed, only the formats of the exemption forms.

## **Machinery for New and Expanded Industry - Revenue Form 51A111**

**Regulation 103 KAR 30:120** explains the various requirements for a piece of machinery to qualify for this exemption. Since the new and expanded industry exemption is dependent on the facts and circumstances of each business enterprise which may be entitled to claim the exemption, the acceptance by a retailer of the appropriate certificate is sufficient to relieve the retailer from the responsibility of any subsequent tax liability determined to be due. However, a retailer would not be exercising “Good faith” if he accepted a new and expanded industry exemption certificate for property that clearly did not qualify for exemption. For example, a retailer cannot accept a new and expanded industry exemption certificate for property that the retailer knew was purchased for use outside Kentucky.

There is no limitation to the type of evidence which a purchaser may present. The evidence, must, however, involve the seller and/or previous owner to establish clear and conclusive proof that the equipment has never been installed in plant facilities in this state.

Where a manufacturer and contractor jointly issue a certificate for machinery for new and expanded industry, the manufacturer and the contractor are jointly liable for the use tax.

As a general rule, the Department looks to the manufacturer for any tax due on questionable purchases. However, this general rule does not apply when:

- ◆ The contractor utilizes the certificate to purchase construction machinery and equipment for his use in performing the job for the manufacturer.
- ◆ The contractor has utilized the certificate to purchase materials to be used on a job other than those for which the certificate applies.

The contract entered into between the contractor and the manufacturer concerning the issuance of a **Certificate of Exemption Machinery for New and Expanded Industry (51A111)** is one of convenience. It is most convenient for the contractor in that he can freely purchase the qualifying items as needed without consulting the manufacturer on each item. This is especially convenient for the manufacturer. The manufacturer can have practically a turnkey purchase where he issues checks to the contractor based upon either the completed contract method or the percentage of completion method of income recognition. However, the manufacturer must rely on the competency of the contractor not to exceed the parameters defined in the certificate.

Since this certificate is a certificate of exemption, a contractor alone cannot qualify to issue such an instrument; rather, the contractor is acting on behalf of the manufacturer. However, the burden of proof that all purchases qualify for the new and expanded industry exemption still rests with the manufacturer.

**Enterprise Zone Sales and Use Tax Exemption Certificate for Building Materials - Revenue Form 51A152** must be executed by the property owner located within an enterprise zone. If the building materials are being purchased by a contractor for use in fulfilling a contract for a project located in an enterprise zone, then the certificate must be jointly executed by the property owner and the contractor under contract with the person or entity entitled to the exemption. Vendors must maintain the original copy of the certificate in their files as evidence of the exempt sale and they must send the duplicate copy to the Department of Revenue with the appropriate month's sales and use tax return.

**Enterprise Zone Sales and Use Tax Exemption Certificate for Qualified Business - Revenue Form 51A151** must be issued for the purchase of new and used equipment and machinery by a qualified business located within an enterprise zone to claim an exemption from sales and use tax. As with the building materials exemption, the vendor must maintain the original copy of the certificate in his file as evidence of the exempt sale and he must send the duplicate copy to the Department of Revenue with the appropriate month's sales and use tax return.

### **Direct Pay Authorization (DPA)**

Under **Regulation 103 KAR 31:030 – Direct Pay Authorization** a taxpayer who qualifies for a DPA is required to issue his DPA to all vendors of tangible personal property, excluding energy vendors. Recognize that a direct pay is not technically an exemption, as it merely shifts the responsibility for the payment of the sales and use tax to the direct pay holder. In effect the direct pay holder is agreeing to accrue and pay tax directly to the Department of Revenue on all purchases which are used in a manner which subjects them to the sales and use tax. DPA may not be issued to contractors since they are not selling tangible personal property. Additional information can be found in **Section EE – Direct Pay Authorization**, Part II.

### **Direct Pay Authorization (Truck Part)**

A motor carrier wishing to apply must complete an application for a truck part direct pay authorization (**Form 51A160**). The Department will issue approved applicants a truck part direct pay authorization letter to provide to all vendors from whom the motor carrier purchases repair and replacement parts. At the end of calendar year 2004, and each subsequent year for which the exemption is claimed, the truck part direct pay holder must file an annual report summarizing the repair and replacement part activity in Kentucky. Additional information can be found in **Section EE – Direct Pay Authorization**, Part II.

### **Energy Direct Pay Authorization (EDPA)**

**KRS 139.480(3)** provides an exemption for entities engaged in manufacturing, processing, mining or refining to the extent that the cost of energy or energy-producing fuels exceeds three percent (3%) of the cost of production. **Regulation 103 KAR 30:140 - Energy and Energy-Producing Fuels** provides guidance to taxpayers who desire to apply for the EDPA. In addition, the regulation provides the definition for the term "cost of production." The vendor's responsibility with respect to the Energy Direct Pay Authorization is the same as that of the Direct Pay Authorization. Additional information can be found in **Section I, Part III**.

**Certificate of Exemption – Out-of-State Delivery for Aircraft, Mobile/Manufactured Homes, Campers, Boats, Motors or Trailers (51A154)**

The Department recognizes that in some cases, retailers have not kept proper documentation to support deductions for sales in interstate commerce taken on sales and use tax returns. In response, **Form 51A154 – Certificate of Exemption – Out-of-State Delivery for Aircraft, Mobile/Manufactured Homes, Campers, Boats, Motors or Trailers** has been developed.

**Form 51A154** does serve as the necessary documentation and is designed for retailers claiming sales of tangible personal property such as aircraft, mobile homes, campers, boats, motors or trailers as sales in interstate commerce. Additional information can be found in **Section G – Interstate Commerce**, Part II.

**Equine Water Exemption**

**Form 51A157 – Certificate of Exemption – Water Used in Raising Equine** was created for the exemption, effective July 15, 1998, for water used in the raising of equine as a business. Vendors must retain a properly completed certificate from eligible customers and label the deduction from sales on line 18 or 19 of **Form 51A102 – Sales and Use Tax Return**, as *equine water exemption*. Vendors may not accept **Form 51A158 – Farm Exemption Certificate**, for sales of water to horse farms.

**GOOD FAITH - ILLUSTRATED**

**Facts/Scenario** - In each situation assume that the vendor is the taxpayer being audited.

**Situation #1:**

Certificate of Exemption for Machinery for New & Expanded Industry obtained at the time of sale (there at start of audit).

Fully complete, but not a valid exemption being claimed. (Service Enterprise claiming up front capital equipment exemption.)

**Explanation/Solution:**

It is recognized that the General Assembly has effectively restricted the avenue of assessment against the seller (vendor) and shifted the Department’s responsibility to secure compliance from the numerous purchasers who have issued invalid exemption certificates.

However, the seller (vendor) is still required to exercise “Good faith” in the acceptance of certificates of exemption. “Good faith” is defined in **KRS 139.490** (until 7/01/04) and **KRS 139.270** (effective 7/01/04) as the acceptance of a signed certificate (properly completed) at the time of sale and maintenance of a file of such certificates in accordance with **KRS 139.720**. Furthermore, it is

the Department's position that "Good faith" is not present when the certificate being issued does not apply to the purchaser's business.

In this situation it is obvious that a service enterprise does not engage in manufacturing and therefore the vendor, in good faith, cannot accept a **Certificate of Exemption for Machinery for New & Expanded Industry (51A111)**. Accordingly, the audit adjustment would entail the disallowance of the deduction and assessing the seller (vendor).

**Situation #2:**

Certificate of Exemption for Machinery for New & Expanded Industry obtained after the time of sale (during audit or 60-day period).

Fully complete, but not a valid exemption being claimed. (Service Enterprise claiming up front capital equipment exemption.)

**Explanation/Solution:**

In addition, to what has been said above, in that the certificate was not taken at the time of sale, "Good faith" is automatically not present and such certificate is subject to more scrutiny than those obtained at the time of sale and retained on file. It was and still is the Department's position that certificates obtained by a seller (vendor) after the fact for items which are clearly taxable (no exemption exists) are not valid and do not relieve the seller (vendor) from the tax liability. Accordingly, the audit adjustment would entail the disallowance of the deduction and assessing the seller (vendor).

**Situation #3:**

Retailer has accepted a certificate of exemption for property not normally utilized in the purchaser's type of business. (Acceptance of a **Certificate of Exemption for Machinery for New and Expanded Industry** from a manufacturer for the purchase of a set of golf clubs.)

**Explanation/Solution:**

The seller (vendor) is required to exercise "Good faith" in the acceptance of certificates of exemption. "Good faith" is defined in **KRS 139.490** (until 7/01/04) and **KRS 139.270** (effective 7/01/04) as the acceptance of a signed certificate (properly completed) at the time of sale and maintenance of a file of such certificates in accordance with **KRS 139.720**. Furthermore, it is the Department's position that "Good faith" is not present when the property purchased is not of the kind utilized in the purchaser's type of business.

In this situation it is obvious that a set of golf clubs is not utilized in manufacturing. Accordingly, the vendor, in good faith cannot accept a **Certificate of Exemption for Machinery for New & Expanded Industry (51A111)**. The audit adjustment would entail the disallowance of the deduction and assessing the seller (vendor).

**Situation #4:**

Retailer has accepted a certificate of exemption that does not apply to the purchaser's type of business or organization. (Acceptance of a purchase exemption certificate from a plumbing business or restaurant.)

**Explanation/Solution:**

The seller (vendor) is required to exercise "Good faith" in the acceptance of certificates of exemption. "Good faith" is defined in **KRS 139.490** (until 7/01/04) and **KRS 139.270** (effective 7/01/04) as the acceptance of a signed certificate (properly completed) at the time of sale and maintenance of a file of such certificates in accordance with **KRS 139.720**. Furthermore, it is the Department's position that "Good faith" is not present when the certificate does not apply to the purchaser's business or organization.

It is obvious that a **Purchase Exemption Certificate (51A126)** is applicable only to exempt organizations such as resident, nonprofit, educational, charitable and religious institutions. Restaurants or plumbing businesses are not exempt organizations and therefore the vendor, in good faith, cannot accept such a certificate. Accordingly, the audit adjustment would entail the disallowance of the deduction and assessing the seller (vendor).

**Situation #5:**

Farmer issues a farm exemption certificate for both taxable and exempt business property.

**Explanation/Solution:**

In regard to the acceptance of the **51A158**, the same requirements of good faith are imposed as for the Purchase Exemption Certificate. The retailer needs only to compare the box checked on the certificate with the property purchased to determine if the purchaser is entitled to the exemption. However, when a retailer accepts from a farmer **Revenue Form 51A158** and the property purchased is not of the kind identified on the certificate as being exempt from the tax, the retailer is not relieved of the responsibility for the appropriate amount of tax due on the sale. Accordingly, on audit, assess the seller (vendor) for items not designated by the farmer on the certificate.

## **Situation #6:**

Manufacturer and contractor jointly issue a certificate for machinery for new and expanded industry and the contractor utilizes the certificate to purchase construction machinery and equipment for his use in performing the job for the manufacturer.

## **Explanation/Solution:**

Where a manufacturer and contractor jointly issue a certificate for machinery for new and expanded industry, the manufacturer and the contractor are jointly liable for the use tax.

As a general rule, the Department looks to the manufacturer for any tax due on questionable purchases. However, this general rule does not apply when:

- ◆ The contractor utilizes the certificate to purchase construction machinery and equipment for his use in performing the job for the manufacturer.
- ◆ The contractor has utilized the certificate to purchase materials to be used on a job other than those for which the certificate applies.

Accordingly, the audit adjustment would entail taxing the contractor on the purchase price of the property.

## **AUDIT PROCEDURE – PURCHASER**

### **Verification That Certificates Were Issued By Purchaser**

Upon issuance of a certificate of exemption to a seller, the purchaser certifies in writing that such purchaser will assume any resulting tax liability. As a general rule, verifying that seller has a certificate on file by telephone is sufficient evidence to hold the purchaser liable for the tax.

However, in light of the decision in Stoner Creek Stud, Inc., if after telephone verification, the taxpayer continues to protest the issue in the audit, it will be necessary to obtain copies of the certificates in question from the sellers.

### **Treatment of Sales on Which Tax is Deleted by Purchaser**

If the seller does not timely obtain a certificate of exemption, the fact that the purchaser deletes the tax or tax reimbursement from the seller's billing, provides their exemption number to the seller, or informs the seller that the transaction is not taxable does not relieve the seller from liability for the tax nor from the burden of proving the sale was to an exempt purchaser or for an exempt purpose. Consequently, when auditing the vendor, assess tax accordingly. However, if auditing the purchaser and it is apparent that the purchaser intended to purchase the item tax-free, such purchaser will be deemed liable for the tax.

### **Verification of Payment of Use Tax by Purchaser**

In those situations where certificates of exemption have been disallowed and the retailer claims that the purchaser has paid the use tax directly to the Department of Revenue, the field auditor will be requested to obtain from the retailer a notarized affidavit signed by the purchaser (owner, partner or officer) stating that it has paid tax on its sales and use tax return or through audit.

### **Payment on Return**

The signed notarized affidavit will be considered as satisfactory evidence of payment, unless there is evidence that the contents of the affidavit are incorrect.

### **Payment Through Audit**

The sale will only be deleted from the vendor's audit upon verification through the Division of Protest Resolution that the contents of the affidavit are correct. In addition, if the vendor does not have a certificate of exemption on file from the purchaser, the purchaser must include in the affidavit a statement that it will not seek a refund from the Department of Revenue on the basis that the tax was the vendor's liability. Copies of all such affidavits are to be included in the audit file.

## **LISTING OF APPLICATIONS FOR AND CERTIFICATES OF EXEMPTION**

Vendors who are updating their customer records must be sure to maintain any old certificates on file until the entire statute of limitation period expires.

### **Applications**

51A109	Application for Energy Direct Pay Authorization
51A112	Application for Direct Pay Authorization
51A125	Application for Purchase Exemption
51A216	Application for Pollution Control Tax Exemption Certificate
51A223	Application for Alcohol Production Facility Tax Exemption Certificate
51A228	Application for Fluidized Bed Combustion Facility
51A160	Application for Truck Part Direct Pay Authorization

### **Certificates of Exemption**

51A105	Resale Certificate
* 51A106	Agricultural Certificate of Exemption
51A111	Certificate of Exemption, Machinery for New and Expanded Industry
51A126	Purchase Exemption Certificate
51A127	Out-of-State Exemption Certificate
51A128	Solid Waste Recycling Machinery Exemption Certificate
51A143	Purchase Exemption Certificate-Watercraft Industry
* 51A148	Farm Machinery Exemption Certificate
* 51A148-S1	Certificate of Exemption for On-Farm Grain or Soybean Facilities
51A149	Certificate of Exemption for Pollution Control Facilities
51A150	Aircraft Exemption Certificate
51A151	Enterprise Zone Sales and Use Tax Exemption Certificate for Qualified Business
51A152	Enterprise Zone Sales and Use Tax Exemption Certificate for Building Materials

* 51A153	Certificate of Exemption for On-Farm Chicken or Livestock Raising Facilities
51A154	Certificate of Exemption – Out-of-State Delivery for Aircraft, Mobile/Manufactured Homes, Campers, Boats, Motors and Trailers
* 51A155	Certificate of Exemption for Ratite Bird Production
* 51A156	Certificate of Exemption for On-Farm Llama/Alpaca Production
* 51A157	Certificate of Exemption for On-Farm Llama/Alpaca Production
51A158	Farm Exemption Certificate
51A159	On-Farm Facilities Certificate of Exemption for Materials, Machinery and Equipment
51A222	Certificate of Exemption for Alcohol Production Facilities
51A227	Certificate for Resale (Schools)
51A229	Fluidized Bed Combustion Facility Tax Exemption Certificate

Effective 7/15/98 these agricultural certificates were replaced by the **Farm Exemption Certificate - Form 51A158** and the **On-Farm Facilities Certificate of Exemption for Materials, Machinery and Equipment - Form 51A159**.

## **MULTIPLE POINTS OF USE AND DIRECT MAIL**

### **General Information**

As a result of enacting Streamlined Tax Conformity Legislation, consider the following:

If a business purchaser of a service, prewritten computer software delivered electronically, or a digital good is not the holder of a direct payment permit and knows at the time of purchase that the good or service will be concurrently available for use in more than one location, the purchaser is required to provide to the retailer at the time of purchase a Multiple Points of Use (MPU) form disclosing that fact.

The purchaser must also apportion the purchase price of the good or service among the locations using a reasonable, uniform, consistent method that is supported by the purchaser's business records as those business records exist at the time of the transaction.

Upon receipt of the form, a retailer is not liable to collect or remit sales and use tax for that transaction. The form will remain in effect for all future transactions between the retailer and the purchaser until the form is revoked in writing by the purchaser.

A purchaser is not required to provide to a retailer the form if the purchaser is the holder of a direct pay permit.

The SSUTA also has a uniform exemption certificate (**Streamlined Sales Tax Agreement – Certificate of Exemption**) that took effect 10/1/05. It became effective when the Agreement kicked in 10/05, when ten states comprising of at least 20% of the population of states that impose a sales tax have enacted legislation. That threshold has been passed, but every state has a different effective date for its conforming legislation. To access the Streamlined Sales Tax Agreement Certificate of Exemption go to [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org) and select Approved Certificate of Exemption.

The applicable statutes are **KRS 139.776 – Multiple Points of Use Exemption Form** and **KRS 139.777 – Direct Mail**.

# Streamlined Sales Tax Agreement Certificate of Exemption

## Streamlined Sales Tax Agreement Certificate of Exemption

Approved by the SSTP at its January 13, 2004 Meeting  
Form not effective until 10 states with 20 percent of the popula-  
tion have been deemed to be in compliance with the agreement.

### Warning to purchaser:

This is a multi-state form. Not all states allow all exemptions listed on this form. Purchasers are responsible for knowing if they qualify to claim exemption from tax in the state that is due tax on this sale. The state that is due tax on this sale will be notified that you claimed exemption from sales tax. You will be held liable for any tax and interest, as well as civil and criminal penalties imposed by the member state, if you are not eligible to claim this exemption. **Sellers may not accept a certificate of exemption for sales sourced within the state if an exemption does not apply in the seller's state.**

Enter the two-letter postal abbreviation for the state under whose laws you are claiming exemption.

Check one:

- Single purchase certificate.** Relates to invoice/purchase order # \_\_\_\_\_.
- Blanket certificate.** If checked, this certificate continues in force until canceled by the purchaser.

Print or type	Name of purchaser _____			
	Business address _____	City _____	State _____	Zip code _____
	Purchaser's tax ID number _____		State of issue _____	Country of issue _____
	If no tax ID number, enter one of the following:	FEIN _____	Driver's license number/State issued ID number state of issue _____ number _____	Foreign diplomat number _____
	Name of seller from whom you are purchasing, leasing or renting _____			
Type of business	Seller's address _____			
	City _____		State _____	Zip code _____

**Type of business.** Circle the number that describes your business.

- |   |                                       |
|---|---------------------------------------|
| 01 Accommodation and food services            | 11 Transportation and warehousing     |
| 02 Agricultural, forestry, fishing, hunting   | 12 Utilities                          |
| 03 Construction                               | 13 Wholesale trade                    |
| 04 Finance and insurance                      | 14 Business services                  |
| 05 Information, publishing and communications | 15 Professional services              |
| 06 Manufacturing                              | 16 Education and health-care services |
| 07 Mining                                     | 17 Nonprofit organization             |
| 08 Real estate                                | 18 Government                         |
| 09 Rental and leasing                         | 19 Not a business                     |
| 10 Retail trade                               | 20 Other (explain) _____              |

**Reason for exemption.** Circle the letter that identifies the reason for the exemption.

- |   |   |
|---|---|
| A Federal government (department) _____         | H Agricultural production # _____   |
| B State or local government (name) _____        | I Industrial production/manufacturing # _____   |
| C Tribal government (name) _____                | J Direct pay permit # _____   |
| D Foreign diplomat # _____                      | K Multiple points of use (services, digital goods, or computer software delivered electronically) |
| E Charitable organization # _____               | L Direct mail # _____   |
| F Religious or educational organization # _____ | M Other (explain) _____   |
| G Resale # _____                                |   |

I declare that the information on this certificate is correct and complete to the best of my knowledge and belief.

Sign here	Signature of authorized purchaser _____	Print name here _____	Title _____	Date _____
	_____			

# RESALE CERTIFICATES

## INTRODUCTION

This section deals with the audit methods and procedures to be utilized when dealing with acceptance of resale certificates.

### **KRS 139.270 – Resale Certificate**

**139.270 Resale certificate.** (Effective until July 1, 2004)

- (1) The resale certificate relieves the seller from the burden of proof only if taken in good faith from a person who:
  - (a) Is engaged in the business of selling tangible personal property;
  - (b) Holds the permit provided for in KRS 139.250; and
  - (c) At the time of purchasing the tangible personal property, indicates his intention to sell it in the regular course of business by executing the resale certificate.
- (2) "Good faith" shall be demonstrated by the seller if he:
  - (a) Accepts a properly completed resale certificate;
  - (b) Maintains a file of such certificate in accordance with KRS 139.720; and
  - (c) Determines that the kind of property being sold to the purchaser is normally offered for resale in the type business operated by the purchaser and that the property, if delivered by the seller, is delivered to the purchaser's business address. The seller is also relieved if the purchaser is unable to ascertain at the time of purchase whether the property will be sold or will be used for some other purpose.
- (3) If the cabinet later finds that the seller exercised good faith according to the provisions of subsection (2) of this section but that the purchaser used the property in a manner that would not have qualified for resale status, the cabinet shall hold the purchaser liable for the remittance of the tax and may apply penalties provided in KRS 139.990.

**Effective:** July 15, 1988

**History:** Amended 1988 Ky. Acts ch. 135, sec. 2, effective July 15, 1988. -- Amended 1982 Ky. Acts ch. 208, sec. 1, effective July 15, 1982. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 27, effective February 5, 1960.

**139.270 Resale certificate or certificate of exemption.** (Effective July 1, 2004)

- (1) The resale certificate or certificate of exemption relieves the retailer or seller from the burden of proof only if taken in good faith from a person who, at the time of purchasing the tangible personal property:
  - (a) Indicates an intention to sell it in the regular course of business by executing the resale certificate; or
  - (b) Indicates that the property purchased will be used in an exempt manner by executing a certificate of exemption.

This relief from liability does not apply to a retailer or seller who fraudulently fails to collect the tax or solicits purchasers to participate in the unlawful claiming of an exemption.
- (2) "Good faith" shall be demonstrated by the retailer or seller if the retailer or seller:
  - (a) Accepts a properly completed resale certificate or certificate of exemption; and
  - (b) Maintains a file of the certificate in accordance with KRS 139.720.
- (3) If the cabinet later finds that the retailer or seller exercised good faith according to the provisions of subsection (2) of this section but that the purchaser used the

property in a manner that would not have qualified for resale status or the purchaser issued a certificate of exemption and used the property in some other manner or for some other purpose, the cabinet shall hold the purchaser liable for the remittance of the tax and may apply penalties provided in KRS 139.990.

**Effective:** July 1, 2004

**History:** Amended 2003 Ky. Acts ch. 124, sec. 14, effective July 1, 2004. -- Amended 1988 Ky. Acts ch. 135, sec. 2, effective July 15, 1988. -- Amended 1982 Ky. Acts ch. 208, sec. 1, effective July 15, 1982. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 27, effective February 5, 1960.

**KRS 139.270** was amended in 2005 to replace the word cabinet with department.

### **KRS 139.410 – Resale Certificate**

**139.410 Resale certificate.** (Effective until July 1, 2004)

- (1) The resale certificate relieves the person selling the property from the burden of proof only if taken in good faith from a person who:
  - (a) Is engaged in the business of selling tangible personal property;
  - (b) Holds the permit provided for by KRS 139.250; and
  - (c) At the time of purchasing the tangible personal property, indicates his intention to sell it in the regular course of business by executing the resale certificate.
- (2) "Good faith" on the part of the seller shall be demonstrated by the seller if he:
  - (a) Accepts a properly completed resale certificate;
  - (b) Maintains a file of such certificate in accordance with KRS 139.720; and
  - (c) Determines that the kind of property being sold to the purchaser is normally offered for resale in the type business operated by the purchaser and that the property, if delivered by the seller, is delivered to the purchaser's business address. The seller is also relieved if the purchaser is unable to ascertain at the time of purchase whether the property will be sold or will be used for some other purpose.
- (3) If the cabinet later finds that the seller exercised good faith according to provisions of subsection (2) of this section and that the purchaser used the property in a manner that would not have qualified for resale status, the cabinet shall hold the purchaser liable for the remittance of the tax and may apply penalties provided in KRS 139.990.

**Effective:** July 15, 1988

**History:** Amended 1988 Ky. Acts ch. 135, sec. 4, effective July 15, 1988. -- Amended 1982 Ky. Acts ch. 208, sec. 2, effective July 15, 1982. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 40, effective February 5, 1960.

**KRS 139.410** was repealed, effective 7/1/04, due to duplication of language in **KRS 139.270**.

## Regulation 103 KAR 31:111 – Sales and Purchases for Resale

103 KAR 31:111. Sales and purchases for resale.	Page 1 of 1
<b>103 KAR 31:111. Sales and purchases for resale.</b>	
RELATES TO: KRS 139.260, 139.270, 139.280, 139.290, 139.300, 139.400, 139.410, 139.420, 139.430, 139.440, 139.760, 139.990	
STATUTORY AUTHORITY: KRS Chapter 13A, 131.130	
NECESSITY, FUNCTION, AND CONFORMITY: To consolidate and clarify various provisions of the sales and use tax law as they relate to the authorized issuance of resale certificates by purchasers and acceptance thereof by sellers.	
Section 1. Every person selling tangible personal property in this state must obtain from the purchaser a certificate of resale on all tangible personal property sold in this state for the purpose of resale. The certificate must be taken in good faith, as defined in KRS 139.270, from a person engaged in selling tangible personal property who at the time of purchase, either intends to sell the property in the regular course of business, or cannot, at the time of the purchase, ascertain whether it will be sold or not. The certificate shall be of two (2) types:	
(1) "Single purchase certificate" on which the purchaser must itemize the property to be purchased. A single purchase certificate may only be used for a single purchase of commodities for resale and cannot be used for subsequent purchases.	
(2) "Blanket certificate" on which the purchaser is required to generally describe the kind of property to be purchased for resale in the regular course of his business. A purchaser who has executed a blanket certificate shall not be required to execute additional certificates of resale for individual purchases so long as there is no change in the character of his operation and the purchases are of tangible personal property of the kind usually purchased by the purchaser for resale.	
Section 2. As provided in KRS 139.260, all sales for resale which are not supported by a properly executed resale certificate shall be deemed retail sales and the burden of proving that the sale is not at retail is upon the seller.	
Section 3. The certificate shall be substantially in the form prescribed below. It must include the number of the permit held by the purchaser, but if he is not required to hold a permit because he is a nonresident purchaser not required to register in Kentucky, he shall make a notation on the face of the certificate to the effect that he is a nonresident purchaser not required to register and obtain a permit in Kentucky. The certificate, in all cases, must be signed by the purchaser, bear his name and address, and indicate the general character of the property sold by the purchaser in the regular course of his business. The purchaser shall clearly mark on the certificate whether it is a single purchase certificate or a blanket certificate.	
Section 4. The following form of resale certificate is prescribed by the cabinet pursuant to KRS 139.280 and 139.420:	
____ Blanket Certificate	
____ Single Purchase Certificate	
I HEREBY CERTIFY: That I hold a valid Retail Sales and Use Tax Permit, Account No. _____, issued pursuant to the Sales and Use Tax Law; that I am engaged in the business of selling _____; that the tangible personal property described herein which I shall purchase from _____ will be resold by me; provided, however, that in the event any such property is used for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, it is understood that I am required by the Sales and Use Tax Law to report and pay the tax measured by the purchase price of such property.	
Description of property to be purchased:	
For a Single Purchase Certificate, itemize the tangible personal property to be purchased; for a Blanket Certificate, give a general description of the kind of property to be purchased for resale in the regular course of the purchaser's business.	
Purchaser:	
Address:	
Dated:	
At:	
Section 5. Improper use of a certificate of resale by a purchaser shall be grounds for the Revenue Cabinet to revoke the purchaser's sales and use tax permit. Criminal penalties shall apply as provided in KRS 139.990.	
Section 6. "Good faith" on the part of the seller shall be deemed to be absent if the seller has facts which give rise to a reasonable inference that the purchaser does not intend to resell the property but instead intends it for his own use or consumption. (17 Ky.R. 1257; eff. 11-21-90.)	

As a result of Streamlined Tax Conformity Legislation **Regulation 103 KAR 31:111 – Sales and Purchases for Resale** is planned to be amended.

## **KRS 139.280 – Contents and Form of Certificate**

**139.280 Contents and form of certificate.** (Effective until July 1, 2004)

- (1) The certificate shall:
  - (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 sold by the purchaser in the regular course of business.
- (2) The certificate shall be substantially in such form as the cabinet may prescribe.

**Effective:** February 5, 1960

**History:** Created 1960 Ky. Acts ch. 5, Art. I, sec. 28, effective February 5, 1960.

**139.280 Contents and form of certificate.** (Effective July 1, 2004)

- (1) The resale certificate shall:
  - (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 sold by the purchaser in the regular course of business.
- (2) The certificate shall be substantially in a form as the cabinet may prescribe.
- (3) A signature shall not be required if the purchaser provides the retailer with an electronic resale certificate.

**Effective:** July 1, 2004

**History:** Amended 2003 Ky. Acts ch. 124, sec. 15, effective July 1, 2004. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 28, effective February 5, 1960.

**KRS 139.280** was amended in 2005 to replace the word cabinet with department.

**KRS 139.280(3)** (Effective July 1, 2004) provides that “A signature shall not be required if the purchaser provides the retailer with an electronic resale certificate.”

## **KRS 139.420 - Contents and Form of Certificate**

**139.420 Contents and form of certificate.** (Effective until July 1, 2004)

- (1) The certificate shall:
  - (a) Be signed 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 sold by the purchaser in the regular course of business.
- (2) The certificate shall be substantially in such form as the cabinet may prescribe.

**Effective:** February 5, 1960

**History:** Created 1960 Ky. Acts ch. 5, Art. I, sec. 41, effective February 5, 1960.

**KRS 139.420** was repealed, effective 7/1/04, due to duplication of language in **KRS 139.280**.

## **KRS 139.430 - Property Used by Purchaser after Giving Certificate**

### **139.430 Property used by purchaser after giving certificate.**

If a purchaser who gives a certificate makes any storage or use of the property other than retention, demonstration or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used. If the sole use of the property, other than retention, demonstration or display in the regular course of business, is the rental of the property while holding it for sale, the purchaser shall pay the tax on the use measured by the amount of the rental charged rather than the sales price of the property to him.

**Effective:** August 1, 1985

**History:** Amended 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 9, effective August 1, 1985. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 42, effective February 5, 1960.

**Legislative Research Commission Note.** 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 11, directed that the provisions of this section would be effective August 1, 1985.

**KRS 139.270 - Resale Certificate, KRS 139.410 - Resale Certificate, Regulation 103 KAR 31:111 - Sales and Purchases for Resale, KRS 139.280 and KRS 139.420 - Contents and Form of Certificate** and **KRS 139.430 - Property Used by Purchaser after Giving Certificate** address this issue.

## **GENERAL OVERVIEW**

Sales for resale is the most common deduction claimed and the auditor/reviewer should be familiar with all of the methods used by the taxpayers in compiling the amounts reported and the various auditing procedures used to verify those amounts.

Whenever feasible, the procedures should be adapted to the method used by the taxpayer in reporting, as this makes it easier to reconcile audit findings with reported figures, and usually reduces auditing time. Examination of taxpayer's working papers and a conference with him will disclose the method used.

## **AUDIT PROCEDURE - VENDOR**

### **Verify Deductions Taken are Substantiated by Resale Certificates**

Sales for resale should be summarized by months or by quarters in accordance with the taxpayer's listings to be used as a basis for verification of the deduction.

Sales invoices should be examined to determine that the claimed amounts are included in total sales and that the correct amounts have been scheduled. Verify that the deduction on the return is

correct, i.e., amounts claimed do not include nontaxable items (interstate commerce, labor, etc.) claimed under some other classification, and that no part of the invoice represents a taxable sale. Documentary evidence such as resale certificates, purchase orders, correspondence, or contracts should be examined. Purchase orders, correspondence or contracts may support a finding that a claimed sale for resale is taxable even though a resale certificate is on file.

In cases in which there is no documentation of which sales were deducted, request that the taxpayer's representative prepare a detailed listing of all sales for resale deducted, allowing a reasonable amount of time to do so. When this work has been completed, the audit procedure will be the same as set forth above. If the taxpayer cannot support the claimed deduction, then such deduction must be disallowed.

### **Verify Acceptability of Documentary Evidence Supporting Deduction**

A claimed sale for resale should be allowed if it is supported by a resale certificate that is proper in form and taken in good faith from a person who is engaged in the business of selling tangible personal property and either holds a Kentucky seller's permit or is a nonresident purchaser not required to register in Kentucky. A letter covering a specific purchase from an out-of-state retailer or from a Kentucky purchaser is acceptable if all the elements of a resale certificate are shown therein. A resale certificate which has been faxed is acceptable provided that it contains all of the required information and is accepted in good faith.

The statute does not require that a seller have a resale certificate on file in order to establish that the transaction constitutes a sale for resale. If the seller can establish that the property was sold for resale, the absence of a resale certificate is not fatal to the claim of exemption. Accordingly, if the retailer can establish that the transaction was a sale for resale, the deduction should be allowed without requiring the taxpayer to obtain a resale certificate after the fact. Personal knowledge of the auditor gained from other audits or sources that the purchase was actually made for resale purposes would also suffice.

Purchase orders containing blocks to be marked taxable or exempt can be accepted in lieu of resale certificates, if the purchase orders contain the necessary information required by **Regulation 103 KAR 31:111(3)**. In lieu of incorporating all of the information required by **103 KAR 31:111**, the purchaser may issue a blanket resale certificate to the vendor and explain that they will designate the taxable status of each purchase order.

Resale certificates from out-of-state purchasers will be honored when issued in accordance with **Regulation 103 KAR 31:111(3)**. The certificate must include the statement that the purchaser is not a resident of Kentucky and must include an address. Certificates issued by non-residents not engaged in a retail trade will not be honored where it can be established that the Kentucky vendor has knowledge of the purchaser's business. For example, certificates from non-resident mining companies will be honored. Certificates from non-resident contractors will not be honored.

Generally speaking, resale certificates will not be honored if accepted by a vendor from a manufacturer when the item being purchased is merely identified as mine supplies. In such cases,

the vendor will be given the opportunity to secure a properly completed certificate from the purchaser. However, a resale certificate will not be honored for purchases prior to the date of the certificate unless the vendor obtains a statement signed by the purchaser (owner, partner or officer) indicating that the certificate was intended to apply to earlier periods and specifying the periods of application.

Single purchase resale certificates apply only to one specific transaction. In the absence of a specific invoice number, it would apply to the transaction closest to the date of issuance of the certificate.

A purchaser who has executed a blanket certificate shall not be required to execute additional certificates of resale for individual purchases so long as the purchases are of tangible personal property of the kind usually purchased by the purchaser for resale.

A resale certificate issued by an apparent retailer stating the products to be purchased as "General Merchandise" would be honored if complete in every respect and it indicates that the purchaser was engaged in selling general merchandise.

Make sure that the taxpayer understands that any of the above evidence by itself is not equivalent of a resale certificate timely taken in good faith, and may not relieve the seller of the liability for the tax.

A resale certificate bearing a 900,000 series number (consumer use tax number) is not valid any time and will not relieve the seller of the tax liability. Such a certificate is only issued to entities which make no sales in the regular course of their business. A 900,000 series number entered as the account number on a resale certificate would indicate that the certificate is not properly filled out per **KRS 139.280**, hence the certificate could not be accepted in good faith.

#### **"Good Faith" (Audit Periods Until July 1, 2004)**

It is necessary to examine the resale certificates to determine whether each certificate is sufficient in content and whether the seller acted in good faith in accepting the certificates.

The nature of transactions and the type and number of items purchased should be scrutinized to determine whether the resale certificates have been taken in good faith.

Good Faith is 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 and that the property if delivered by the seller is delivered to the purchaser's business address. Accordingly, resale certificates will be honored for any item for which:

- ◆ The item is currently being contested in the court system, or
- ◆ The seller could reasonably believe that the property would normally be resold in the business operated by the purchaser.

Resale certificates will not be honored in situations where the item being purchased is clearly taxable and it cannot be reasonably construed that the item would normally be resold by the purchaser or used in any exempt manner.

In examining the resale certificates consider whether items shown on the invoices are properly included within the general descriptions of the type of property to be purchased. Also consider the use of these items in the purchaser's business.

In making a decision, the auditor/reviewer should be guided by the test of reasonableness. It is necessary to question sales for resale that do not meet such a test or if the seller knows beyond a reasonable doubt that the property was bought for the purchaser's own use. Examples of transactions which should be questioned include:

- ◆ Sale of furniture or fixtures to a grocery.
- ◆ Sale of janitorial supplies to a restaurant.
- ◆ Sale of building materials to a contractor where the terms of sale specify delivery to the job site.
- ◆ Sale of cleaning solvent to a repairman.
- ◆ Tools sold by a parts house to a repair shop.
- ◆ Sales of items such as grease, glue, tire patches, oil dry, hand-cleaner and towels to garages.

When the seller insists a particular item, not reasonably included in the description, was actually sold for resale, the seller should be required to secure a statement from the purchaser covering the specific item in question.

**Section 6 of Regulation 103 KAR 31:111** states that, "Good faith" on the part of the seller shall be deemed absent if the seller has facts which give rise to a reasonable inference that the purchaser does not intend to resell the property but instead intends it for his own use or consumption."

In the absence of a resale certificate, the deduction will be allowed, if the retailer can establish beyond a reasonable doubt that the property was purchased for resale by the buyer. A retailer attempting to prove that the transaction was a "sale for resale", without obtaining an acceptable resale certificate, would be required to obtain documents, such as a sales invoice, or a copy of cancelled check, from his customer showing that the item purchased from the retailer was in fact resold by the retailer's customer as tangible personal property.

### **“Good Faith”/Court Cases (Periods Prior to 7/1/04)**

The Kentucky Court of Appeals in Revenue Dept. v. Warren Chemical & Janitorial Supply Co., Ky. App., 562 S.W. 2d 772 (1977) held that blind acceptance of certificates of resale is not legally acceptable and will not shift the burden from the taxpayer to the Department of Revenue. The Court quoted from a 1949 decision of the Alabama Supreme Court. The Alabama Court in Merriwether v State, 42 So. 2d 465, stated that in cases where a wholesaler sells to customers where the property is resold:

. . .it is his duty to know the general nature of the business conducted by the customer. . .

In the case of Pace Membership Warehouse, Inc. v. Revenue Cabinet, Ky. App., 808 S.W. 2d 353 (1991), the court held that a retail goods dealer is primarily liable for the collection of sales tax from those it sells to unless a certificate of resale is taken and then it is only relieved from the statutory burden to remit the sales tax if the certificate is taken in good faith; in determining this element of good faith, the dealer has a duty to know the general nature of the business conducted by the customer and is bound at his peril when he sells to a customer to know whether the customer is consuming the goods in the course of his business, which would render the transaction taxable, even though the customer may also out of the same lot habitually resell some of them to others.

### **“Good Faith” (Effective 7/1/04)**

When the legislature modified **KRS 139.270 – Resale Certificate** (new **KRS 139.270 – Resale Certificate or Certificate of Exemption**), the main modification involved excluding one section of the statute. The section of **KRS 139.270** which was not included under the new statute is **KRS 139.270 section (2)(c)**. This section for periods until July 1, 2004, reads as follows:

- (2) “Good faith” shall be demonstrated by the seller if he:
  - (c) Determines that the kind of property being sold to the purchaser is normally offered for resale in the type business operated by the purchaser and that the property, if delivered by the seller, is delivered to the purchaser’s business address. The seller is also relieved if the purchaser is unable to ascertain at the time of purchase whether the property will be sold or will be used for some other purpose.

**KRS 139.270 – Resale Certificate or Certificate of Exemption** (Effective July 1, 2004) reads:

- (2) “Good faith” shall be demonstrated by the retailer or seller if the retailer or seller:
  - (a) Accepts a properly completed resale certificate. . .
  - (b) Maintains a file of the certificate in accordance with **KRS 139.720**

Another impact of modifying the statute is that both exemption certificates and resale certificates are referenced together.

The end result is that good faith requirements for both exemption and resale certificates are, for periods after July 1, 2004, substantially the same.

**“Good Faith” When Certificate On File for Audit Periods (Effective 7/1/04)**

One requirement that a vendor must meet in order for a certificate to be considered taken in good faith is that he “Accepts a properly completed resale certificate. . .”

**KRS 139.280 – Contents and Form of Certificate** (Effective July 1, 2004) states in section (1)(c) that the certificate shall: “Indicate the general character of the tangible personal property sold by the purchaser in the regular course of business.” This being the case, the vendor still has some responsibility when examining certificates for acceptance, to determine if the certificate indicates that his customer is in the business of selling the items purchased. As an example of this concept consider the following.

An accounting firm (with a resale number) purchases trash can liners. If the face of the resale certificate indicates that the accounting firm is in the business of selling trash can liners, the vendor can properly accept the certificate in good faith. However, if the face of the certificate indicates that the accounting firm is in the business of providing accounting services then the certificate would not be considered properly filled out per **KRS 139.280** and the vendor could not accept it in good faith.

In this given situation, if the audit was on the vendor and the vendor had not exercised “Good faith” in acceptance of the certificate, the deduction would be disallowed and tax assessed against the vendor. However, if this is discovered in an audit on the purchaser it is obvious that the purchaser fully intended to buy the item tax free and even though “Good faith” was not present on the vendor’s part, the adjustment (use tax) would be made on the purchaser.

**“Good Faith” When Certificate Not On File for Audit Periods (Effective 7/1/2004)**

**KRS 139.270(2)(b)** indicates that one of the requirements for a vendor to meet in order to have taken a certificate in good faith is that he “Maintains a file of the certificate”. If the vendor has not secured a properly filled out certificate at the time of sale, he has not met the requirements of good faith.

The aforementioned notwithstanding, it should be recognized that on many occasions, retailers fail to obtain the proper resale certificate at the time of making the sale. In an attempt to administer the sales and use tax law in a fair manner and to collect only those taxes due, the Department has permitted the taxpayer a grace period in which it can obtain resale certificates after the audit process begins.

It must be understood that resale certificates obtained during this grace period have not been accepted in “good faith” Accordingly, such resale certificates are subject to more scrutiny than those resale certificates obtained at the time of sale and retained on file.

Certificates of resale obtained by a retailer after audit for items which are **clearly taxable (not for resale)** are not valid and do not relieve the retailer from the tax liability. A seller that fails to obtain the resale certificate at the time of sale has failed to exercise good faith by obtaining the required resale certificate and maintaining the file as required by **KRS 139.270**.

**“Good Faith” – Illustrated (Audit Periods 7/1/04 Forward)**

**Facts/Scenario** - In each situation assume that the vendor is the taxpayer being audited.

**Situation #1:**

Resale certificate obtained at the time of sale (there at start of audit) fully complete and valid certificate.

(Pet store claiming resale exemption for dog food.)

**Explanation/Solution:** It is obvious that the vendor has a properly completed resale certificate on file and as a result has complied with “Good faith” requirements. Accordingly, the exemption (deduction) would be allowed.

**Situation #2:**

Resale certificate obtained at the time of sale (there at start of audit) fully complete.

900,000 series number.

(Accountant claiming resale exemption for dog food.)

**Explanation/Solution:** It is obvious that “Good faith” on the part of the seller shall be deemed absent if the seller has facts which give rise to a reasonable inference that the purchaser does not intend to resell the property but instead intends it for his own use or consumption.”

**Situation #3:**

Resale certificate obtained at the time of sale (there at start of audit) fully complete.

Engaged in the business of selling “dog food” in description on certificate (Retailer’s number).

(Accountant claiming resale exemption for dog food.)

**Explanation/Solution:** The deduction would be allowed in that the purchaser does have a retailer’s number and has indicated on the certificate that he will sell dog food. The certificate has been accepted timely and is on file, thus “Good faith” requirement has been met.

**Situation #4:**

Resale certificate obtained at the time of sale (there at start of audit) fully complete.

Engaged in the business of selling “accounting services” in description on certificate.

(Accountant claiming resale exemption for dog food.)

**Explanation/Solution:** “Good faith” is not present as the certificate does not indicate that dog food will be resold. Accordingly, the audit adjustment would entail assessing the vendor (seller).

**Situation #5:**

Resale certificate obtained at the time of sale (there at start of audit) not fully complete.

(Pet store claiming?? (Not complete –no description)

No properly filled out certificate obtained before audit end.

**Explanation/Solution:** “Good faith” requirements have not been met as the certificate has not been properly completed. Accordingly, the audit adjustment would entail disallowance of the deduction, thus assessing the vendor (seller).

**Situation #6:**

Resale certificate obtained after the time of sale (during audit or before audit is submitted).

Fully complete and valid certificate.

(Pet store claiming resale exemption for dog food.)

**Explanation/Solution:** Although “Good faith” was technically not met in this situation, it is standard procedure for auditors to allow the vendor time to secure the proper documentation. In that the vendor (seller) has complied, the deduction would be allowed.

**Situation #7:**

Resale certificate obtained after the time of sale or during audit or before audit is submitted.

Fully complete, save for description.

(Accountant claiming resale certificate for dog food.)

**Explanation/Solution:** It is obvious that the vendor does not have a properly completed resale certificate on file and as a result has not complied with “Good faith” requirements. Accordingly, the exemption (deduction) would be disallowed.

**Situation #8:**

Resale certificate obtained after the time of sale. Not fully complete.

(Pet store claiming?? (Not complete, no description)

No properly filled out certificate obtained before audit end.

**Explanation/Solution:**

See answer to **Situation #5.**

**Situation #9:**

Vendor completes resale certificates on behalf of the purchaser or blatantly solicits such certificates by including the resale certificates as part of the credit application.

**Explanation/Solution:** It has historically been the Department's position that "Good faith" is not necessarily present if the vendor has a policy of soliciting such certificates. **KRS 139.270(1)**, effective 7/1/04, specifically addresses this issue. The end result is that the exemption would be disallowed and the vendor (seller) assessed accordingly.

**Situation #10:**

Acceptance of resale certificate when the purchaser knows at the time of sale "description-engaged in the business of selling does not match purchase" that the property is not going to be resold by the purchaser in the regular course of business.

**Explanation/Solution:** "Good faith" is lacking in that the certificate has not been properly completed. In accordance with **KRS 139.280**, it is necessary for the purchaser to indicate the general character of the tangible personal property being sold. This requirement has not been met. Assess the vendor (seller.)

**Misuse of Resale Certificates**

When sales for resale are examined during the course of an audit/review, particular attention should be paid to transactions that may involve the misuse of a resale certificate. Misuse occurs when the seller knows at the time of sale that the property is not going to be resold by the purchaser in the regular course of business. Another misuse is if the vendor is completing the certificates on behalf of the purchaser.

The vendor should not solicit resale certificates. An example would be a situation where the vendor includes resale certificates as a part of a credit application.

If it is determined that the seller makes a practice of accepting defective resale certificates, the seller's good faith is in doubt and the tax should be asserted against the seller.

When an examination of sales for resale discloses a possible misuse of a resale certificate, it is standard procedure to provide the Audit Selection Section with leads on taxpayers suspected of misusing resale certificates. This includes leads where tax has been asserted against the seller. Leads should include photocopies of invoices and resale certificates for any questionable sales for resale. If this is not possible, the questionable transaction must be scheduled separately from the audit working papers. The photocopies or schedules should not be made part of the audit working papers.

### **Treatment of Sales on which Tax is Deleted by Purchaser**

If the seller does not timely obtain a resale certificate, the fact that the purchaser deletes the tax or tax reimbursement from the seller's billing, provides their permit number to the seller, or informs the seller that the transaction is not taxable does not relieve the seller from liability for the tax nor from the burden of proving the sale was for resale. Consequently, when auditing/reviewing the vendor, assess tax accordingly. However, if auditing/reviewing the purchaser and it is apparent that the purchaser intended to purchase the item tax-free such purchaser will be deemed liable for the tax.

### **Verification of Payment of Use Tax by Purchaser**

In those situations where resale certificates have been disallowed and the retailer claims that the purchaser has paid the use tax directly to the Department of Revenue, the field auditor will be requested to obtain from the retailer a notarized affidavit signed by the purchaser (owner, partner or officer) stating that it has paid such tax on its sales and use tax return or through audit.

### **Payment on Return**

The signed notarized affidavit will be considered as satisfactory evidence of payment of the tax unless there is evidence that the contents of the affidavit are incorrect.

### **Payment Through Audit**

The sale will only be deleted from the vendor's audit upon verification through the Division of Protest Resolution that the contents of the affidavit are correct.

In addition, if the vendor does not have a resale certificate on file from the purchaser, the purchaser must include in the affidavit a statement that it will not seek a refund from the Department of Revenue on the basis that the tax was the vendor's liability. Copies of such affidavits are to be included in the audit file.

## **AUDIT PROCEDURE - PURCHASER**

### **Verification That Certificates Were Issued By Purchaser**

When a purchaser issues a resale certificate to a seller, the purchaser is certifying in writing that he will assume any resulting tax liability. As a general rule, verifying the seller has a certificate on file by telephone is sufficient evidence to hold the purchaser liable for the tax. However, in light of the decision in Stone Creek Stud, Inc., if after telephone verification, the taxpayer continues to protest the issue in the audit, it will be necessary to obtain copies of the certificates in question from the sellers.

In the event the taxpayer accepts the auditor's findings in the Field so that copies are not obtained but raises the issue again with the Division of Protest Resolution, the audit will be reassigned for copies of the certificates to be obtained.

### **Uniform Sales and Use Tax Certificate - Multijurisdiction**

On October 7, 1998, Kentucky authorized vendors to accept the **“Uniform Sales and Use Tax Certificate - Multijurisdiction”** certificate. However, acceptance/issuance is under the following conditions:

- ◆ Kentucky does not permit the use of this certificate to claim a resale exclusion for the purchase of a taxable service.
- ◆ This certificate is not valid as an exemption certificate. Its use is limited to use as a resale certificate subject to the provisions of good faith as outlined in **KRS 139.270**.
- ◆ The use of this certificate by the purchaser constitutes the issuance of a blanket certificate in accordance with **Kentucky Administrative Regulation 103 KAR 31:111**.

The SSUTA also has a uniform exemption certificate (**Streamlined Sales Tax Agreement – Certificate of Exemption**) that took effect 10/1/05. It became effective when the Agreement kicked in 10/05, when ten states comprising of at least 20% of the population of states that impose a sales tax have enacted legislation. That threshold has been passed, but every state has a different effective date for its conforming legislation. To access the Streamlined Sales Tax Agreement Certificate of Exemption go to [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org) and select Approved Certificate of Exemption.