



Avalara

Tax compliance done right



Managing tax-exempt sales 201:

Advanced strategies and best practices

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Matthew MacNeil, Director of Technical Consulting, Avalara

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Continuing Professional Education (CPE)



Qualifying for credit

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 - Questions display for a limited amount of time
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Downloading Certificate

- Download the certificate once you qualify
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- Those that qualify will also receive their certificate in a post-event email

➤ **Meet your presenters**

Your presenters



Andrew Quirk

*Product Solution Consultant,
Avalara*

Andrew is focused on aligning exemption management solutions to customers' business needs. He's passionate about improving the exempt customer experience and helping businesses automate their traditionally labor-intensive and risk-prone sales tax compliance activities.



Matthew MacNeil

*Director of Technical Consulting,
Avalara*

Matthew co-founded the Avalara CertCapture product line, now known as Avalara Exemption Certificate Management, which was initially developed by his company, Tax Technology Services.

> CPE question 1

Agenda

01 Exempt sales and nexus

02 Exemption sales use cases

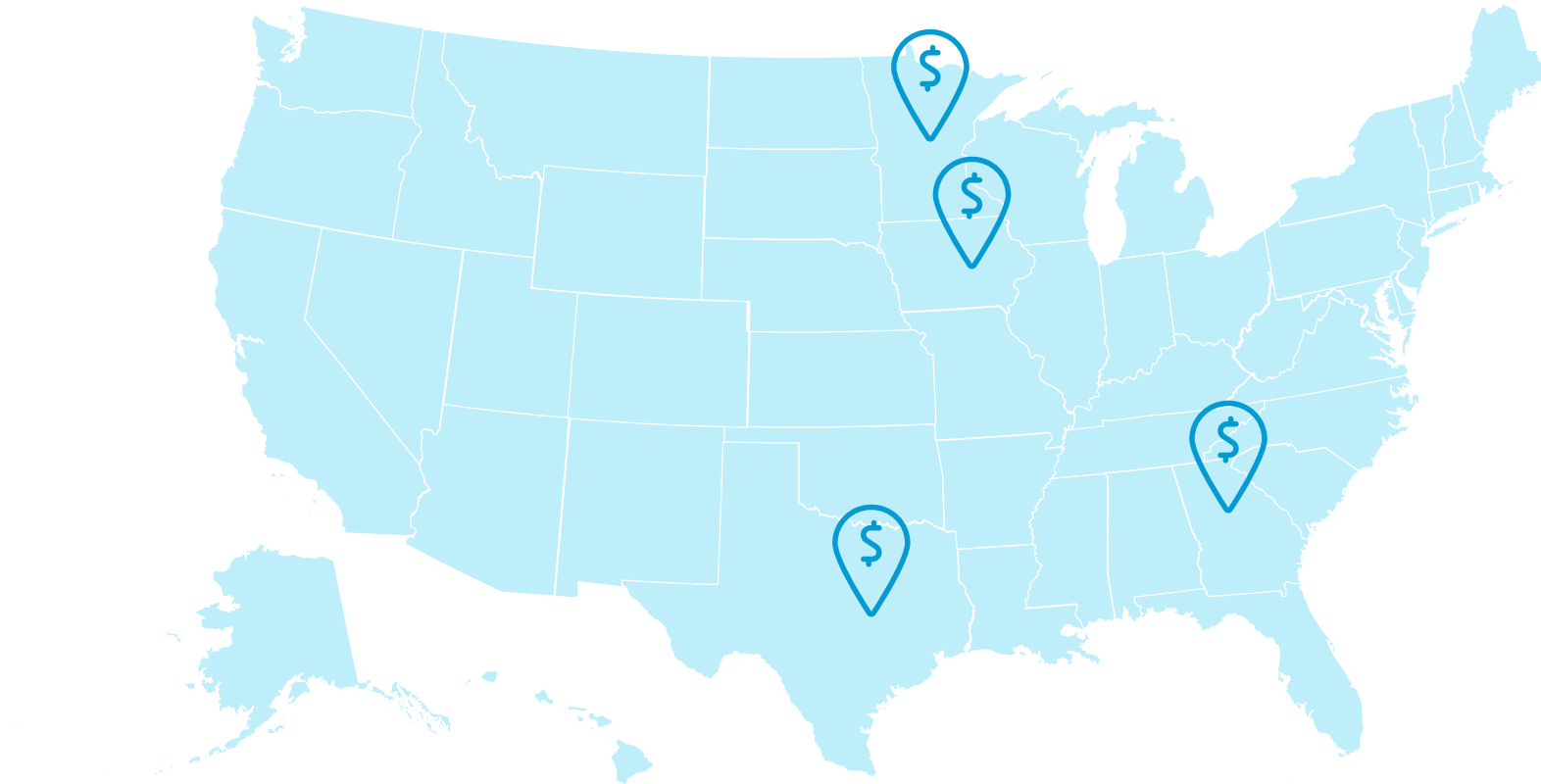
03 Managing expiring exemption certificates

04 Audit prep

05 Q&A

Exempt sales and nexus

In the beginning, there was physical nexus ...



Example: A distributor selling nationwide but with only four locations usually only had a to worry about tax compliance in those four states.

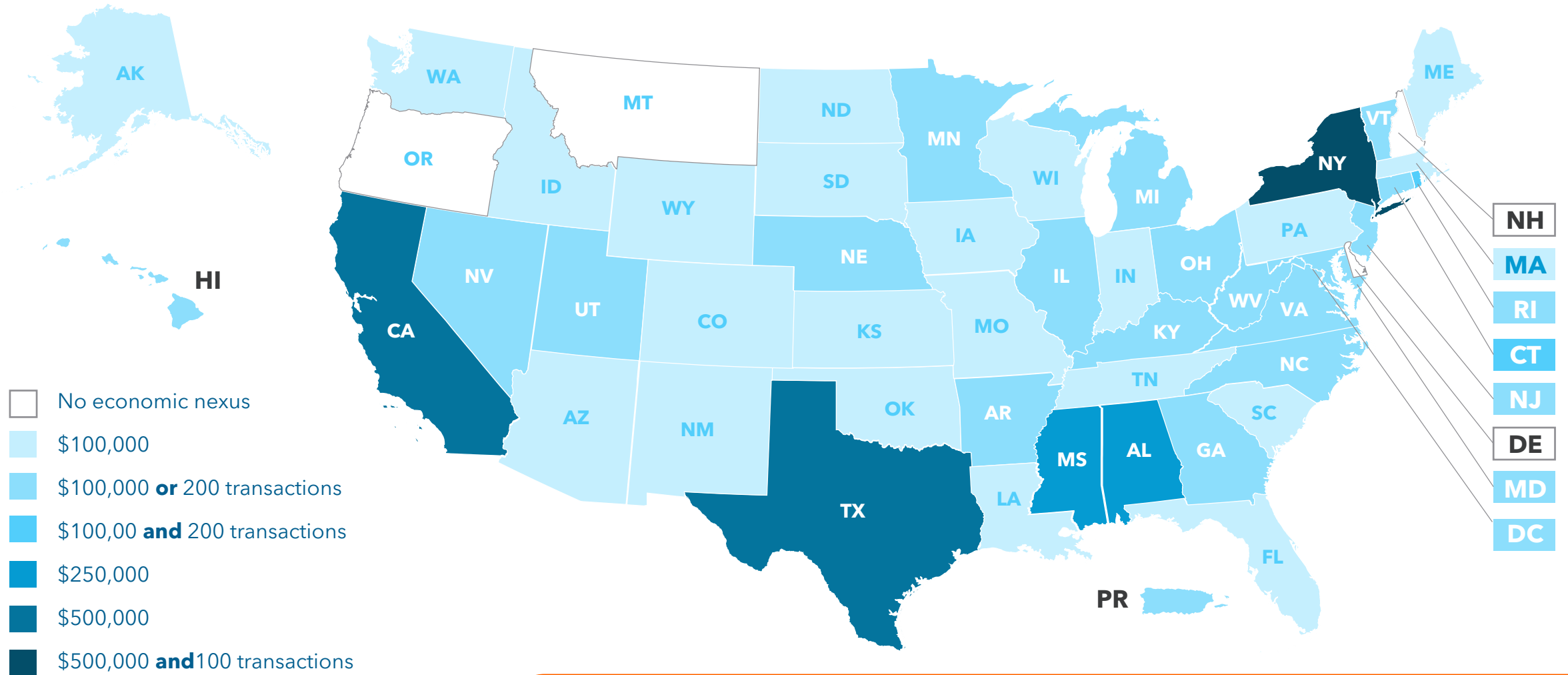
...then there was **South Dakota v. Wayfair, Inc.**

- Upended the tax compliance landscape
- Tax-free shopping on the internet became a thing of the past and businesses now must collect across the country



The net result of the Wayfair decision is that businesses everywhere need to pay attention to tax rules in every state where they have sales.

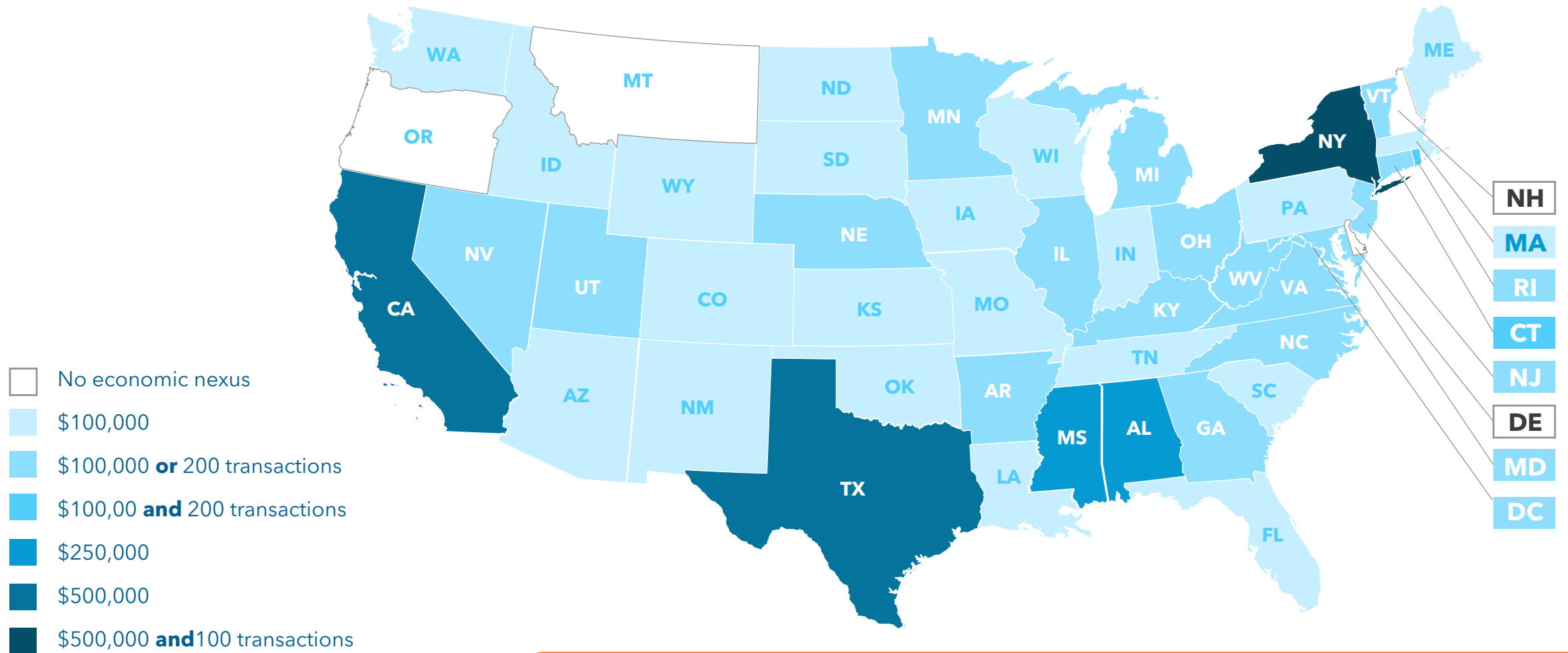
Economic nexus thresholds by state



Source: Avalara, as of January 2024: [Avalara](#) (subject to change)

Use our free **sales tax risk assessment** to determine where you have nexus.

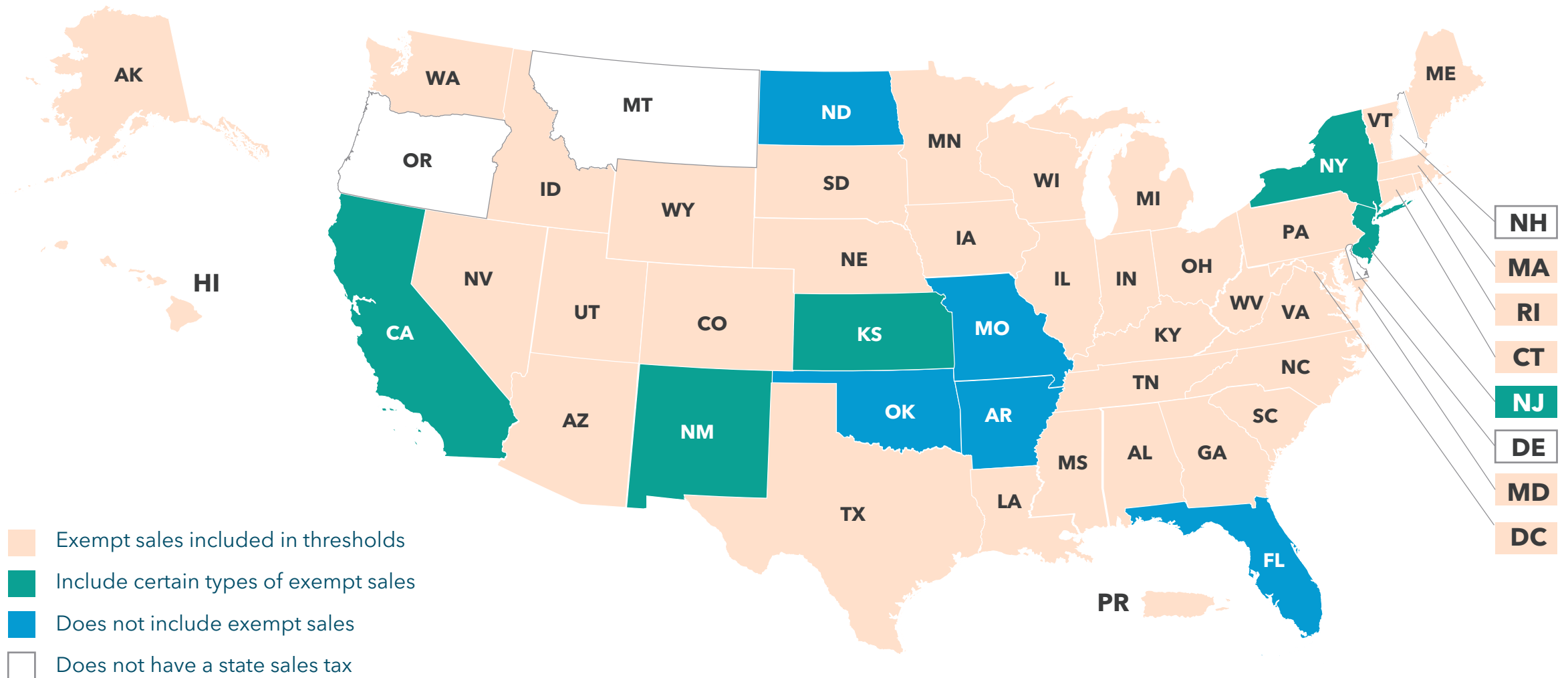
Economic nexus thresholds by state



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Economic nexus with exempt sales



Source: [Avalara – State By State Registration Requirements For Marketplace Sellers](#)

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Nexus and exempt sales considerations



Inclusion of exempt sales in nexus calculations

Businesses selling primarily **exempt products or services** may unknowingly trigger nexus and be subject to reporting obligations.



Registration and filing requirements

Even if all sales are **exempt**, a business that surpasses a state's economic nexus threshold may still need to register.

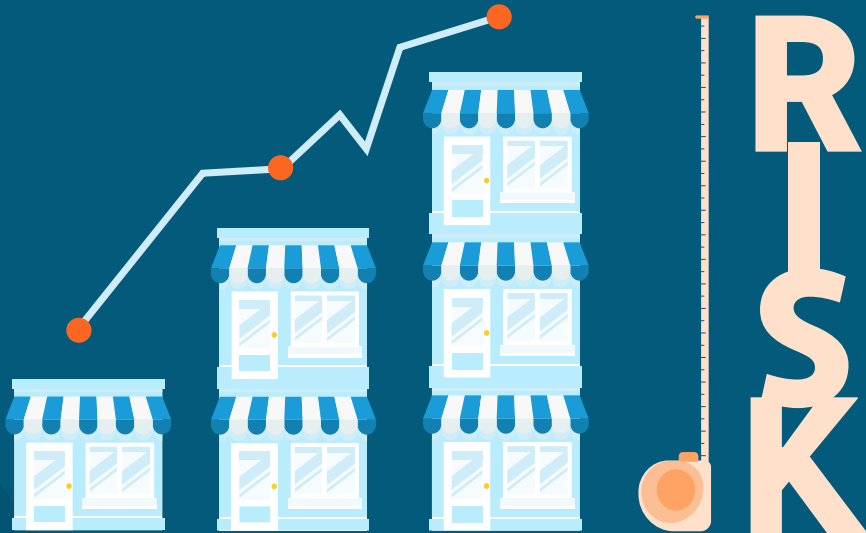


State-by-State Variability

Exemption rules differ by state, meaning a product or service considered exempt in one jurisdiction may be taxable in another.



As businesses grow, complexity multiplies – and tax risk increases



Growing businesses generate exponential tax compliance complexities

New geographies

States, countries

New sales channels

Wholesale, retail, ecommerce, marketplaces

More technologies

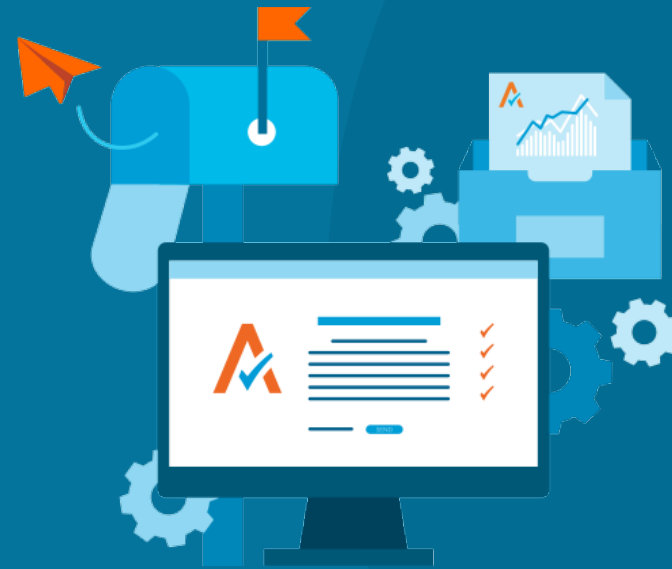
Different invoicing systems (ERPs, ecommerce shopping carts, mobile, CRM)

Use tax

Understanding and managing risks and opportunities

The burden of proof is on you

- While customers must provide documentation, the burden is on the SELLER during an audit to prove why tax was not charged.
- Your \$0 sales tax liability is tied to those documents.
- With fines and penalties, you can owe the state double the tax you failed to collect.



> CPE question 2

The background is a solid dark blue color. It features several large, semi-transparent geometric shapes: circles and triangles in various shades of blue, some overlapping each other. These shapes are distributed across the frame, with some appearing in the corners and others more centrally. The overall effect is a modern, abstract design.

> Exempt sale reasons

What makes a sale exempt?

Exempt sale rules vary by state but generally follow key principles to determine when a sale qualifies for sales tax exemption

Common reasons

Non-profit

Usage

Resale

**Direct pay
permits**

**Interstate
sales**

**Agriculture
exemption**

**Medical and
healthcare
exemptions**

**Software-as-
a-service**

Government

**Tribal
government**

**Manufacturing
exemption**

**Product-based
exemptions**

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Usage

Non-profit organizations

What is it

Certain organizations qualify for sales tax exemptions on purchases made for official use.

Who qualifies

- Nonprofits (e.g., charities, foundations)
- Religious organizations (e.g., churches, temples)
- Educational institutions (e.g., schools, universities)
- Government entities (e.g., federal, state, and local agencies)

How it works

- Purchases must be for official organizational use (not personal use).
- A valid exemption certificate must be presented to the seller.
- Some states require pre-approval or special tax-exempt status registration.

Why it matters

Helps reduce costs for mission-driven organizations and ensures compliance with tax laws.



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Usage: Manufacturing

What is it	Sales tax exemptions for materials and equipment used in manufacturing, processing, or production.
Who qualifies	Manufacturers, processors, and industrial businesses purchasing eligible supplies.
How it works	<ul style="list-style-type: none">• Exempt Items: Raw materials, machinery, equipment, and sometimes utilities (electricity, gas, water) used directly in production.• Purpose: Items must be directly involved in the manufacturing process.
Why it matters	Lowers production costs, promotes industrial growth, and prevents tax from being passed through multiple supply chain stages.



Resale transactions

What is it	Sales of goods to businesses that intend to resell them are exempt from sales tax.
Who qualifies	Retailers, wholesalers, and distributors purchasing inventory for resale.
How it works	<ul style="list-style-type: none">• Buyer provides a valid resale certificate to the seller.• Sales tax is collected only when the final consumer purchases the item.
Why it matters	Prevents double taxation and ensures tax is applied at the correct stage.



Direct pay

What is it

Allows qualified businesses to purchase taxable goods and services without paying sales tax at the time of purchase, instead remitting use tax directly to the state.

Who qualifies

Large business, government agencies, certain exempt organizations.

How it works

- The business provides a Direct Pay Permit instead of paying sales tax to the vendor.
- The company self-assesses, and remits use tax directly to the state.

Why it matters

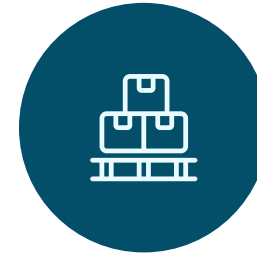
Simplifies tax reporting for businesses with complex purchasing operations. Ensures proper tax allocation across multiple jurisdictions.



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> Drop shipping

Drop shipments defined



Manufacturer (Third Party)
Manufacturer/originator/supplier of goods, the “Drop Shipper”



Retailer (Vendor)
The entity/seller who has the relationship with the customer



Customer
End user, the final purchaser

When a **manufacturer** accepts an order from a **retailer**, and the **manufacturer** delivers the goods to the **customer** on behalf of the **retailer** in a state where the **manufacturer** and **customer** have nexus.

Drop shipments defined

Retailer (Third Party)

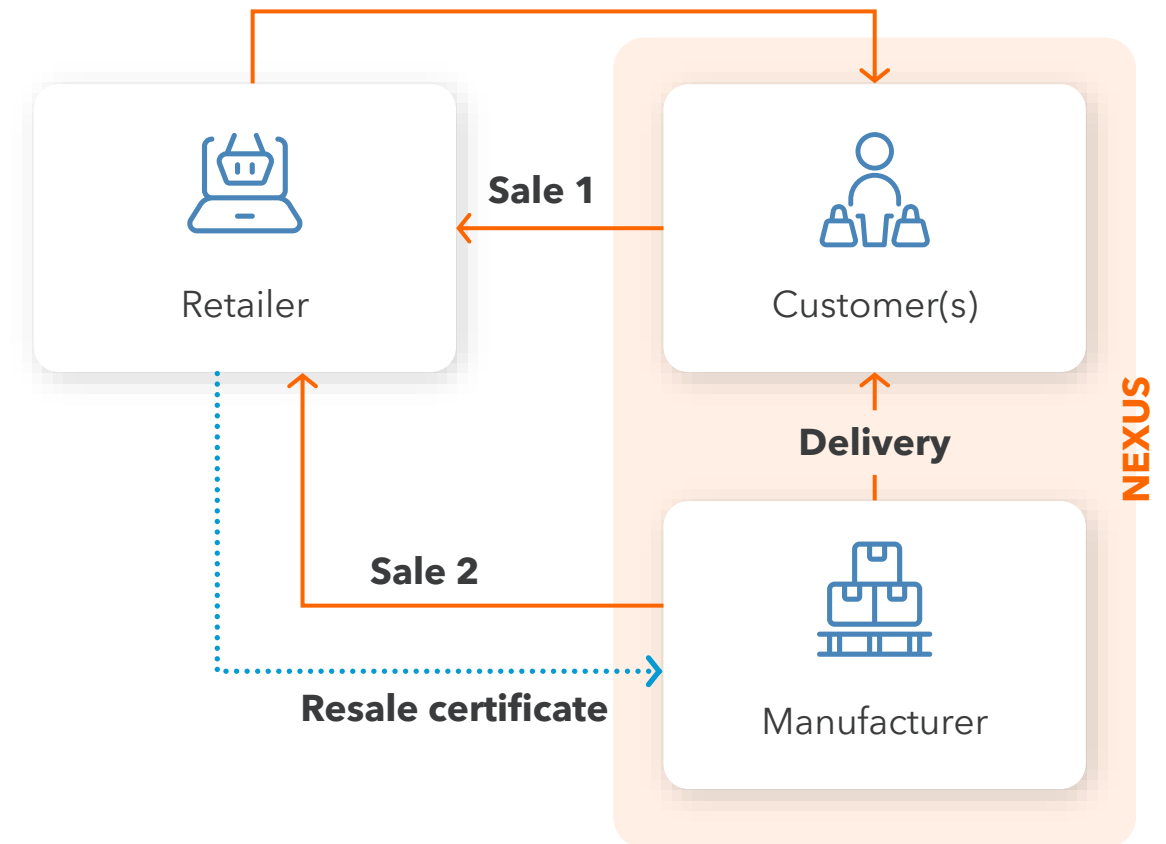
Manufacturer/originator of goods, the "Drop Shipper"

Manufacturer (Vendor)

Wholesaler/distributor (middleman) between the retailer and customer

Customer

End user, the final purchaser



Expiring exemption certificates



Yes, exemption certificates can expire

Expire on a state-by-state basis

- Many states impose a specific validity period for exemption certificates (e.g., one year, two years, or five years).
- After the expiration date, the certificate is no longer valid, and the business must obtain a renewed certificate from the customer.

In some states, certificates do not expire as long as the information on the certificate is still valid



Challenges and considerations

Expiration dates and time periods can change at any time

- Just because the exemption certificate you collected in 2020 was originally good until 2025, that doesn't mean a five-year period still applies.
- The state may have since started requiring renewals every three years.



Challenges and considerations

Changes to customer exemption status

- The information on the certificate needs to remain valid
- Reasons information on an exemption certificate may no longer be valid:
 - Change in tax-exempt business status
 - Business name or legal entity change
 - Business address change
 - Change in operations (i.e. stops reselling goods)
 - Change in state or local laws

Best practices for managing expiring certificates

- Request updates proactively – not after the certificate has expired
- Set internally mandated renewal period even if not required by the state to capture changes to business
- Use software to track and flag expiring certificates

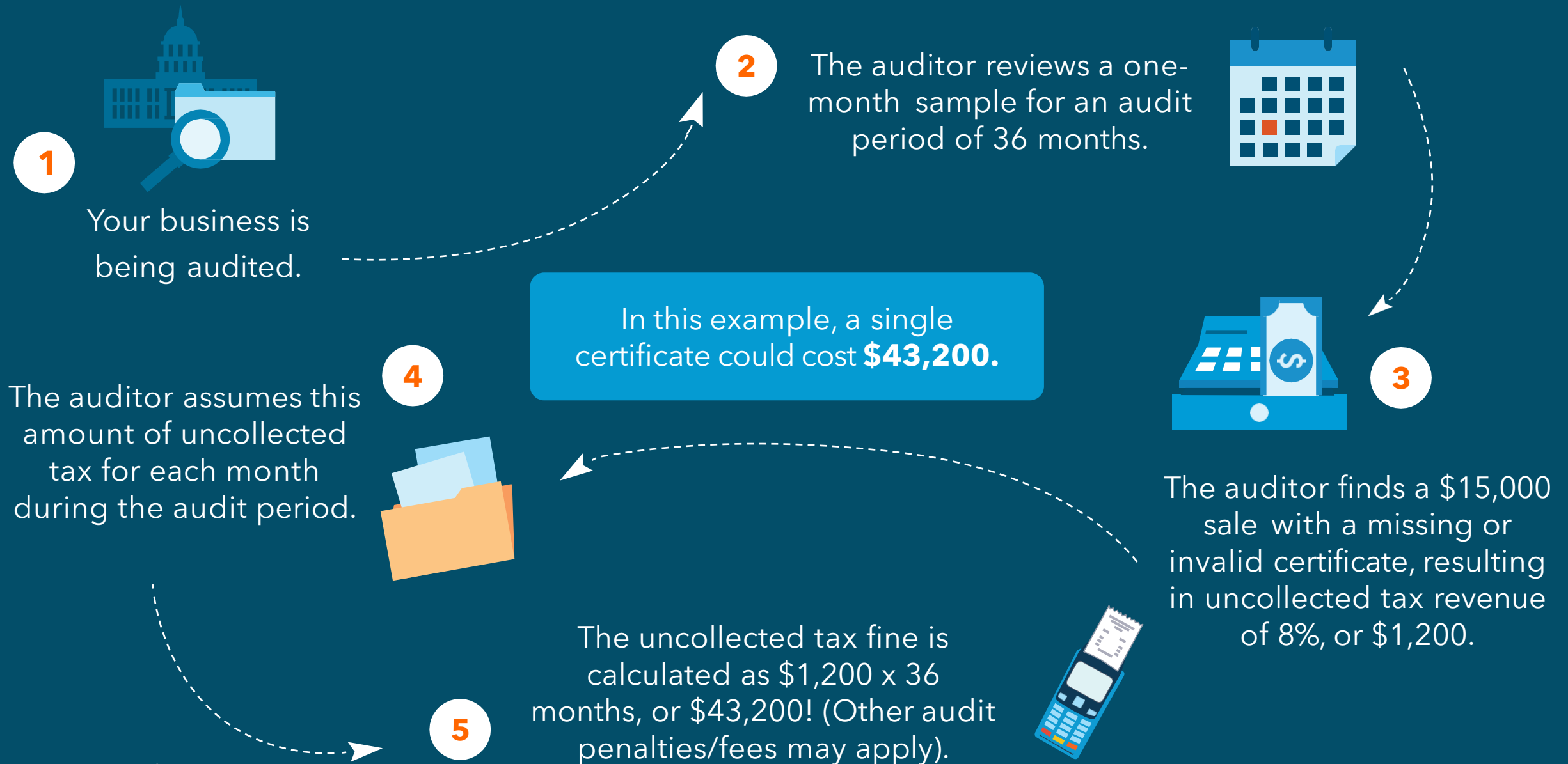


> CPE question 3



Audits

The Cost of a Missing Exemption Certificate



Common audit findings with exemption certificates

CONSIDER THIS

If a vendor closes its doors,
it may be difficult to obtain
exemption certificates afterwards

Unsupported exempt sales

- Lack of valid documentation for sales claimed as exempt
- Date issued does not match invoice date
- Expired

Missing items on exemption certificate

- Signatures
- Issue dates

Unsupported exempt sales

- Wrong claim type
- Certificate not accepted
- Document not recognized by state authority
- Name/address doesn't match direct buyer/seller
- Wrong state tax ID

Common audit triggers

Why do businesses get audited?

CONSIDER THIS

60% of audits target four industries:

Manufacturing
Construction
Wholesalers and distributors
Retail

Triggers

- Nexus discovery (having nexus and not being registered)
- Payroll tax or other state and local tax filings (information sharing)
- Trickle-down referrals through audits of vendors
- Public information



Internet



Tradeshows



Seller website



Marketplace

- Leads/list based on certain industries
- Fulfillment by Amazon (FBA) seller central

Reducing audit costs and saving time with Avalara



85%

Avalara users saw an 85% increase in audit preparation efficiency, saving 34 hours per audit.



416 HRS

Average number of hours saved annually using Avalara Exemption Certificate Management.



\$210,000

Average savings on audits fees and reduced penalties from using Avalara over a three-year period.



Years

Assessments can be applied to transactions dating back years.

Best practices

Exemption certificate best practices

Internal management

1

Establish **clear process and procedures** for managing exempt sales

2

Train employees how to collect and validate exemption certificates

3

Maintain a **central repository** for easy access and storage

4

Establish internal process and cadence for **updating expired documents**

5

Review exemption certificates periodically to confirm process and procedures are being followed

6

Automate storage, validation, renewal reminders, and integrations





> Avalara

Collecting, validating, and maintaining exemption certificates



Directs buyer to proper documentation, eliminating need for onsite expertise.



Insights and centralized collaboration.



Integrates with AvaTax, invoicing platforms, websites and other tax engines for real time verification.

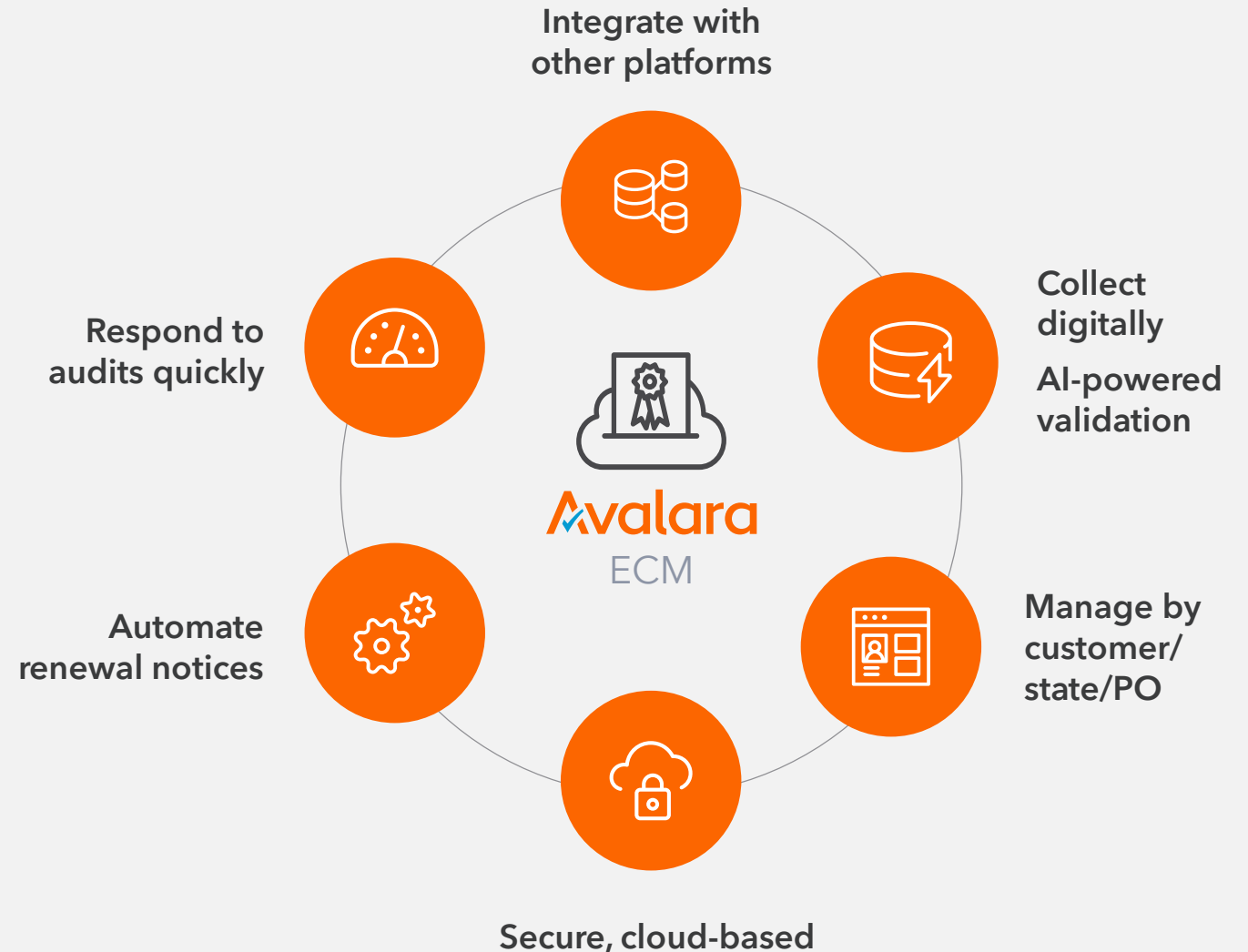


Available ecommerce module, APIs, and professional services.



Extensive reference library of exemptions laws.

Intelligent exemption certificate management



ECM Managed Services

ONE-TIME ECM MANAGED SERVICES

Step 2 of implementation

Following customer-led software setup and upload of clean customer data, Avalara will help you move from your current manual/paper/PDF processes to digitized compliance workflow. We will collect/validate all required customer exemption certificates for your business.

RECURRING ECM MANAGED SERVICES

Ongoing maintenance

Avalara will proactively run reports of certificates due to expire, create campaigns, validate newly received certificates, and provide customer support to ensure all certificates remain up-to-date and your business remains compliant.

> Demo

> CPE question 4

Q&A



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