**Opinion Letter**

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| **Letter Number:** | **O-2002-001** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Direct pay permits.** |
| **Keywords:** |  |
| **Approval Date:** | **01/08/2002** |

**Body:**

Office of Policy & Research

January 8, 2002

XXXX
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XXXX

RE: Your inquiry about direct pay permits

Dear XXXX:

I have been asked to answer your letter that we received late last year. You request a private letter ruling. A private letter ruling is issued only when the taxpayer is identified and when the operative facts are sufficiently complete to allow an opinion to be formed and a determination made. You do not identify the taxpayer nor do you set forth facts that describe its business operates. Accordingly, my letter to you is not a private letter ruling. However, I believe that I can provide you and your client guidance about the questions that you raise.

Your letter discusses whether or not a direct pay permit can be issued to a company (Purchasing Entity) that is created by a client (Operating Entity) to make centralized purchases for the client (Operating Entity). You believe that the Operating Entity can then issue a resale exemption certificate to the Purchasing Entity for the items the Operating Entity uses.

This scheme contains a number of basic flaws as it related to Kansas sales tax. A direct pay permit is issued to taxpayers to exempt purchases of items that they use in their business operations and have difficulty accounting for. For example, a railroad in Kansas may purchase and store rails and ties from an out-of-state vendor for eventual use in several different states. Kansas has a temporary storage rule. Accordingly, the railroad cannot know which state should receive the use tax until the rails or ties are removed from inventory in Kansas and shipped to the site where they are installed. A direct pay permit allows the railroad to pay tax at the time the destination of the rails and ties is fixed. The rails and ties are something that railroads purchase for their own use.

Under your proposal, a direct pay permit would be used as part of an accounting scheme where one entity holds the direct pay permit and sells exempt under a resale exemption certificate to another entity that uses the property. This would be inappropriate because a direct pay permit should not be used only to exempt items that a business, such as the Purchasing Entity, sells and a business, such as the Operating Entity, cannot claim a resale exemption certificate on things that it buys to use or consume.

You also state that the Purchasing Entity intends to use the permit to buy services exempt from sales tax and account for the tax later. You assert that this would enable your client "to simplify and centralize its sales/use tax reporting, review and compliance process." While these are valid reasons for requesting a direct pay permit, you do not explain what the services are. The Secretary of Revenue has broad discretion when issuing direct pay permits, since permits place additional burdens on our audit staff to assure that the permit holder is properly accounting for the taxes owed. Without a full disclosure of the problems that a taxpayer hopes the direct permit will remedy, a direct pay permit should not be issued. Because your letter does not explain what the services are, I can only guess at whether a direct pay permit may be used to benefit the Operating Company. For example, direct pay permits cannot be used to claim exemption on billings from real property contractors since the direct permit holder has no way to account for the tax due on labor services and the tax due on the contractor's purchases. As Notice 98-03 indicates, there may be other situations where a direct pay permit would not benefit the Operating Company.

Please note that reorganization might work if the Operating Company creates a separate division within it to account for the purchases made under a direct pay permit. This would avoid the problems of having two separate legal entities involved with one making and the other honoring improper resale exemption claims. Even if this organizational approach is workable for your client, you still have not identified what services are involved. Without such facts, I can only guess whether a direct pay permit would be appropriate for the Operating Company. While I appreciate your apparent confidentiality concerns, you must provide me with additional information before I can begin to provide you with a meaningful discussion about you client's business plans.

If you and your client choose to provide me with the additional information, I will be happy to review what you send.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 01/09/2002 Date Modified: 01/10/2002**