STATE OF CALIFORNIA

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Executive Director

October 25, 2013

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board. The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17-19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6596

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;

- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

> A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific

> franchisee name(s) for whom the advice is requested for relief from liability under this regulation.
>
> For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable

reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and

common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In

addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1705 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of

Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17-19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at *www.boe.ca.gov*.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1705 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1705, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at *www.boe.ca.gov*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

Initial Statement of Reasons for

Proposed Amendments to California Code of Regulations,

Title 18, Section 1705, *Relief From Liability*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

Revenue and Taxation Code (RTC) section 6005 defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It currently provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the State Board of Equalization (Board) finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under RTC section 6596, subdivision (c), a person requesting RTC section 6596 relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires. And, currently, RTC section 6596,

subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. The first sentence of Regulation 1705, subdivision (e), which was included in the 1999 amendments, currently provides that "[a] trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation."

Further, as relevant here, in 2009, the second sentence was added to subdivision (e) of Regulation 1705 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. The second sentence of Regulation 1705, subdivision (e), currently provides that "[a] franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation."

Furthermore, at the same time in 2009, the second paragraph was added to subdivision (e) of Regulation 1705. The second paragraph explains that "[f]or an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor."

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by

relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Proposed Amendments

Need for Clarification

During its October 23-25, 2012, Board meeting, the Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal concerned the issue of ABC's reliance on an audit report subject to the provisions of Regulation 1705, subdivision (c), not ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that if two persons in the same industry are under common ownership and share accounting functions and accounting staff, then Regulation 1705, subdivision (b) already provides a procedure for their joint representatives to request written advice from the Board that identifies both persons by name so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to

comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) requiring a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s) to specifically identify the member(s) or franchisee(s) that may rely on the written advice for RTC section 6596 relief. Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted an interest parties meeting to discuss the draft amendments in April 2013. During the meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

Business Taxes Committee staff subsequently provided its revised draft amendments to Regulation 1705 to the interested parties and conducted a second interested parties meeting in May 2013. During the meeting, staff received verbal suggestions to add clarifying language and make minor grammatical edits to its revised draft amendments. Therefore, staff made the clarifying and grammatical edits suggested during the meeting, and provided the revised drafts of staff amendments to Regulation 1705 to the interested parties that participated in the May 2013 meeting in case there was a need for further comments.

However, staff did not receive any further comments on its revised drafts of the amendments to Regulation 1705 with the edits suggested at the May 2013 interested parties meeting. Therefore, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members on August 2, 2013, for consideration at the Board's August 13, 2013, Business Taxes Committee meeting.

August 13, 2013 Business Taxes Committee Meeting

Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add the following language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief:

> For the purposes of this section a person is considered to have shared accounting and common ownership if the person:
>
> (1) Is engaged in the same line of business as the audited person,
>
> (2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and
>
> (3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
>
> > (A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.
> >
> > (B) Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns.
> >
> > (C) Shared accounting policies and procedures.
>
> These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common

ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Mr. Joseph Vinatieri of Bewley, Lassleben & Miller, LLP, appeared at the August 13, 2013, Business Taxes Committee meeting. He expressed his support for the amendments to Regulation 1705 recommended in the formal issue paper, and said the amendments are:

- Fair to taxpayers;
- Narrowly crafted to address the issue presented by the facts of ABC's appeal; and
- Consistent with the legislative intent underlying the enactment of RTC section 6596.

Therefore, at the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper.[1] The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary for the specific purpose of addressing the issue (or problem) presented by the facts of ABC's appeal (discussed above).

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The adoption of the proposed amendments to Regulation 1705 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1705.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-006, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its August 13, 2013,

[1] The Board made two minor grammatical changes to the text of the proposed amendments to Regulation 1705, subdivision (c), recommended in Formal Issue Paper 13-006 prior to beginning the rulemaking process. The Board inserted the word "has" between the words "or" and "a" in the proposed amendments adding paragraph (2) to subdivision (c). The Board also added a "s" to the end of the word "maintain" in the proposed amendments adding paragraph (3)(B) to subdivision (c).

Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1705 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1705 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, RTC section 6596, subdivision (c), currently requires a person requesting RTC section 6596 relief to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

As previously explained, the proposed amendments to Regulation 1705:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and
- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

As a result, the proposed amendments will permit some additional persons to qualify for RTC section 6596 relief, and choose to incur any costs associated with requesting relief under RTC

section 6596, subdivision (c). However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under RTC section 6596. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

Furthermore, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 1705. And, each person in the limited class will only be eligible for RTC section 6596 relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 1705 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for RTC section 6596 relief due to the proposed amendments.

Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

In addition, Regulation 1705 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1705 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1705 may affect small businesses.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited <u>or a person with shared accounting and common ownership with the audited person</u> or by a legal or statutory successor to that person.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1705

Title: 1705, *Relief from Liability*

Preparation: Bradley Heller
Legal Contact: Bradley Heller

The proposed amendments to Regulation 1705, *Relief from Liability,* prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person.

History of Proposed Regulation:

December 17-19, 2013	Public Hearing
October 25, 2013	OAL publication date; 45-day public comment period begins; Interested Parties mailing
October 11, 2013	Notice to OAL
August 13, 2013	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA