



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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Executive Director

**January 29, 2016**

**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 1698, *Records*, and Section 4901, *Records***

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) sections 7051, 8251, 9251, 30451, 32451, 40171, 41128, 43501, 45851, 46601, 50152, 55301, and 60601 proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation or Reg.) 1698, *Records*, and Regulation 4901, *Records*. The proposed amendments to both regulations define the term electronic cash register and provide that the term includes integrated point of sale (POS) systems. The proposed amendments add an example to both regulations explaining that if the taxpayer's POS system periodically overwrites stored data, the taxpayer should transfer and maintain a copy of all the data that would be overwritten or otherwise removed for the specified record retention period. The proposed amendments update the term "machine-sensible records" to "electronic records" throughout both of the regulations. The proposed amendments to both regulations clarify that storage-only imaging media includes "PDF files" and the amendments to Regulation 1698 clarify that storage-only imaging media includes "other media used in electronic imaging" to be consistent with the current provisions of Regulation 4901. The proposed amendments also replace the references to the Marine Invasive Species Fee, California Tire Fee, Natural Gas Surcharge, Covered Electronic Waste Recycling Fee, and Water Rights Fee with a reference to the Fee Collection Procedures Law (FCPL) (RTC § 55001 et seq.) in Regulation 4901, subdivision (a)(1), to cover all the taxes and fees currently enacted and administered under the FCPL.

## **PUBLIC HEARING**

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on March 29-30, 2016. 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](http://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 10:00 a.m. or as soon thereafter as the matter may be heard on March 29-30, 2016. 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 Regulations 1698 and 4901.

## **AUTHORITY**

Regulation 1698: RTC section 7051

Regulation 4901: RTC sections 8251, 9251, 30451, 32451, 40171, 41128, 43501, 45851, 46601, 50152, 55301, and 60601

## **REFERENCE**

Regulation 1698: RTC sections 6455, 7053, 7054, and 7153.6

Regulation 4901: RTC sections 8301, 8302, 8303, 8304, 9253, 9254, 30453, 30454, 32551, 32453, 40172, 40173, 40174, 40175, 41056, 41073, 41129.30, 43502, 45852, 46602, 46603, 50153, 55302, 55363.5, 60604, 60605, and 60606

## **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

### Current Law

#### *Sales and Use Tax*

The Board administers California's sales and use taxes. The Board's Sales and Use Tax Department is responsible for administering the Board's sales and use tax programs, including performing audits to ensure that sales and use taxes are reported properly.

There are two statutes related to the retention and examination of records for sales and use tax purposes. RTC section 7053 provides that "[e]very seller, every retailer as defined in subdivision (b) of section 6015, and every person storing, using, or otherwise consuming in this State tangible personal property purchased from a retailer shall keep such records, receipts, invoices, and other pertinent papers in such form as the [B]oard may require."

RTC section 7054 specifies that the Board, or any person authorized in writing by it, “may examine the books, papers, records, and equipment of any person selling tangible personal property and any person liable for the use tax.” It further specifies that the Board “may investigate the character of the business of the person in order to verify the accuracy of any return made” or “if no return is made by the person, to ascertain and determine the amount required to be paid.”

The Board adopted Regulation 1698 to implement, interpret, and make specific RTC sections 7053 and 7054 by specifying the types of records that must be maintained and made available for examination on request by the Board for sales and use tax purposes. The regulation currently allows records to be maintained and made available in hardcopy or electronic format. The regulation also generally requires all records to be preserved for a period of not less than four years, except for records for reporting periods beginning before January 1, 2003, that are subject to the extended ten year statute of limitations contained in RTC section 7073(d), which the regulation requires to be preserved for a period of not less than ten years. The Board made amendments that substantially updated Regulation 1698 in 1997, and added the provisions regarding records for reporting periods beginning before January 1, 2003, in 2005. However, Regulation 1698 has not been substantially updated since 1997.

As relevant here, Regulation 1698 currently defines the terms “database management system,” “electronic data interchange” or “EDI Technology,” “hardcopy,” and “machine-sensible record.” It explains that machine-sensible records do not include hardcopy records “stored in or by a storage-only imaging system such as microfilm or microfiche.” It also provides the requirements for hardcopy records to be converted to “storage-only imaging media, such as microfilm and microfiche.”

### *Special Taxes and Fees*

The Board also administers a number of special taxes and fees, in addition to the sales and use taxes. As relevant here, those special taxes and fees are administered under the Motor Vehicle Fuel Tax Law (RTC § 7301 et seq.), the Use Fuel Tax Law (RTC § 8601 et seq.), the Cigarette and Tobacco Products Tax Law (RTC § 30001 et seq.), the Alcoholic Beverage Tax Law (RTC § 32001 et seq.), the Energy Resources Surcharge Law (RTC § 40001 et seq.), the Emergency Telephone Users Surcharge Law (RTC § 41001 et seq.), the Hazardous Substances Tax Law (RTC § 43001 et seq.), the Integrated Waste Management Fee Law (RTC § 45001 et seq.), the Oil Spill Response, Prevention, and Administration Fees Law (RTC § 46001 et seq.), the Underground Storage Tank Maintenance Fee Law (RTC § 50101 et seq.), the FCPL, and the Diesel Fuel Tax Law (RTC § 60001 et seq.) (hereafter, collectively referred to as special tax and fee laws).

As relevant here, the Covered Electronic Waste Recycling Fee imposed by Public Resources Code (PRC) section 42464 is administered under the FCPL pursuant to PRC section 42464.2. The California Tire Fee imposed by PRC section 42885 is administered under the FPCL pursuant to PRC section 42882. The Lumber Products Assessment imposed by PRC section 4629.5 is

administered under the FCPL pursuant to PRC section 4629.5. The Marine Invasive Species Fee imposed by PRC section 42885 is administered under the FCPL pursuant to RTC sections 44002 and 44003. The Natural Gas Surcharge imposed by Public Utilities Code (PUC) section 890 is administered under the FCPL pursuant to PUC section 893. The Prepaid Mobile Telephony Services Surcharge imposed by RTC section 42010 and Local Charges as defined in RTC section 42101 that are required to be collected by sellers other than direct sellers are administered under the FCPL pursuant to RTC sections 42020 and 42103. And, the Water Rights Fee imposed by Water Code sections 1525 and 13160.1 is administered under the FCPL pursuant to Water Code section 1552.

The Board's Special Taxes and Fee Department is responsible for administering the Board's special taxes and fees programs under the special tax and fee laws.

The Board adopted Regulation 4901 in 2003 to implement, interpret, and make specific the statutes related to the retention and examination of records under the special tax and fee laws, which are similar to RTC sections 7053 and 7054 (discussed above). (RTC §§ 8301, 8302, 8303, 8304, 9253, 9254, 30453, 30454, 32551, 32453, 40172, 40173, 40174, 40175, 41056, 41073, 41129.30, 43502, 45852, 46602, 46603, 50153, 55302, 60604, 60605, and 60606.) As relevant here, Regulation 4901 contains a list of "Applicable Tax Laws" and prescribes the types of records that must be maintained and made available for examination on request by the Board to determine taxpayers' and fee payers' correct liabilities under the applicable tax laws. Regulation 4901 generally mirrors the provisions of Regulation 1698, except that it provides the requirements for hardcopy records to be converted to "storage-only imaging media, such as *microfilm, microfiche or other media used in electronic imaging.*" (Italics added.)

Regulation 4901 was amended in 2010 to clarify that it applies to the Water Rights Fee (enacted in 2003) and Cover Electronic Waste Recycling Fee (enacted in 2004). However, Regulation 4901 has not been substantially updated since it was adopted in 2003 and does not currently refer to the Lumber Products Assessment and the Prepaid Mobile Telephony Services Surcharge, which were enacted, or Local Charges, which the Board was first required to administer under the FCPL, after the regulation was last amended.

### *Electronic Cash Registers*

Cash registers have existed for many years. They offer business owners an organized place to ring up sales and store money from their sales transactions. Electronic cash registers have also been in use for some time and now include a wide range of devices, such as integrated POS systems.

POS systems are sophisticated computer systems that use commercially available operating systems to record each sale when it happens. In recent years, POS systems have become more popular than traditional cash registers with business owners because of their user-friendly interface, data tracking capabilities, and increased affordability. These systems are also popular

because they can be integrated with third-party accounting software, online ordering, and credit and debit card processors.

The Legislature added RTC section 7153.6 to the Sales and Use Tax Law (RTC § 6001 et seq.) and RTC section 55363.5 to the FCPL, effective January 1, 2014. (Stats. 2013, ch. 532.) As relevant here, both status define the term “electronic cash register” to mean “a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data in whatever manner” and both statutes indicate that electronic cash registers include POS systems.

### Effect, Objectives, and Benefits of the Proposed Amendments

#### *Need to Update Regulation 1698*

As new technologies and business practices emerge, the Board must adapt to the new technologies and keep taxpayers informed with relevant guidance using the current terminology in the industry. Board staff determined that there was an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) because Regulation 1698 currently defines the outdated term “machines-sensible record” and generally uses the term to refer to information in an “electronic format,” which is now simply referred to as “electronic records.” Staff determined that there was an issue (or problem) with Regulation 1698 because it does not define the commonly used term electronic cash register or refer to POS systems. Staff also determined that there was an issue with Regulation 1698 because it did not provide guidance to business owners with POS systems that overwrite data after a period of time about how to maintain their data before it is overwritten.

#### *Interested Parties Process*

As a result, the Board’s Business Taxes Committee (BTC) staff prepared draft amendments to update Regulation 1698 and address the issues described above, and a discussion paper explaining the draft amendments. Both were provided to interested parties.

Staff’s draft amendments to Regulations 1698:

- Defined the term “electronic cash register” and explained that the term includes integrated POS systems.
- Replaced the term “machine-sensible record” with “electronic record” and explained that electronic records included records recorded and maintained by electronic cash registers.
- Changed the format of the example provided in subdivision (c)(2)(A).
- Added an example to subdivision (i) to further explain how business owners should maintain their data if they have POS systems that overwrite data after a period of time.

On June 17, 2015, BTC staff conducted an interested parties meeting to discuss the draft amendments. Following the meeting, staff received a submission, dated July 1, 2015, from Mr. Robert Jones of Collins, Mason & Company LLP. Mr. Jones proposed that each occurrence of “microfilm or microfiche” in the regulation be replaced with “microfilm, microfiche, or pdf.”

PDF or “portable document format” is a type of storage-only imaging format that is independent of software, hardware, or operating systems. Invented and developed by Adobe, PDF has become the most popular imaging format since 1994 when Adobe announced that it would provide its Adobe Reader software free online as an open file format. With increased availability and ease of use, PDF files have become the standard for document exchange, almost replacing microfilm or microfiche. Staff agreed with Mr. Jones that PDF is an acceptable record storage format, and as such agreed to add PDF to the regulation where it refers to microfilm and microfiche.

When preparing the second discussion paper and revising the draft amendments to Regulation 1698, BTC staff determined that Regulation 4901 generally mirrors Regulation 1698 (as discussed above). BTC staff also noticed that Regulation 4901 contains language in subdivision (h)(1) and (h)(2) that refers to “microfilm, microfiche or other media used in electronic imaging” (as discussed above). As such, staff revised its draft amendments to Regulation 1698, subdivisions (a)(4), (h)(1), and (h)(2) to replace each occurrence of “microfilm or microfiche” with “microfilm, microfiche, PDF files, or other media used in electronic imaging.”

In addition, BTC staff prepared drafted amendments to update Regulation 4901 that mirrored the amendments to Regulation 1698, discussed above, including adding “PDF files” to subdivisions (a)(5), (h)(1), and (h)(2) of Regulation 4901 to ensure consistency between Regulations 1698 and 4901. Also, to further update Regulation 4901, staff drafted amendments to remove the references to the Marine Invasive Species Fee, California Tire Fee, Natural Gas Surcharge, Covered Electronic Waste Recycling Fee, and Water Rights Fee from subdivision (a)(1)’s list of applicable tax laws and insert a reference to the FCPL to cover all the taxes and fees currently enacted and administered under the FCPL, as well as eliminate the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL.

On August 11, 2015, BTC staff conducted a second interested parties meeting to discuss the draft amendments to Regulations 1698 and 4901. At the meeting, there was overall support for the proposed amendments. Also at the meeting, Mr. Marc Brandeis of Brandeis & Associates, LLC, requested that Excel worksheets and Access databases be included as acceptable forms of records in the regulations. Although staff did not receive a written submission for this request, staff did consider the suggestion. Staff determined that worksheets and database files are not necessarily source data and that they are often summaries or analyses of source data. Staff determined that worksheets and databases are already required to be maintained and made available to the Board under the provisions in subdivision (b)(1)(C) of both regulations, which refer to “schedules or working papers used in connection with the preparation of tax returns.” Additionally, staff determined that it would be unnecessarily restrictive to revise the regulation to

refer to specific proprietary software products, such as Excel and Access. For these reasons, BTC staff did not agree to incorporate Mr. Brandeis's suggestion into staff's draft amendments.

*October 27, 2015, BTC Meeting*

Subsequently, staff prepared Formal Issue Paper 15-011 and distributed it to the Board Members for consideration at the Board's October 27, 2015, BTC meeting. Formal Issue Paper 15-011 recommended that the Board propose to add a definition for "electronic cash register" to subdivision (a)(2) of Regulation 1698 and subdivision (a)(3) of Regulation 4901 to address the second issue (or problem) referred to above. The definitions in the regulations are in alphabetical order, therefore the issue paper recommended that the definition for "electronic cash register" be inserted alphabetically, and the remaining definitions be renumbered.

Subdivision (i) of both regulations explains that records must be kept for a period of not less than four years. The formal issue paper recommended that the Board propose to add an example to this subdivision to address the third issue (or problem) referred to above by explaining that if the taxpayer's POS system periodically overwrites stored data, the taxpayer should transfer and maintain a copy of all the data that would be overwritten or otherwise removed for the specified period.

The formal issue paper recommended that the Board propose to update the term "machine-sensible records" to "electronic records" throughout the regulations to address the first issue (or problem) referred to above. "Machine-sensible records" is an outdated term, and "electronic records" is a current and readily understood term. Board staff also recommended that the Board propose to change the formatting of the regulations in subdivision (c)(2)(A) where they provide examples of what retained records should contain when a taxpayer uses electronic data interchange processes and technology. The recommended amendments reformatted the examples as numbered lists for easier reading and consistent formatting with other subdivisions in the regulations.

Additionally, the formal issue paper recommended that the Board revise Regulation 4901 to remove the references to the Marine Invasive Species Fee, California Tire Fee, Natural Gas Surcharge, Covered Electronic Waste Recycling Fee, and Water Rights Fee from the list of applicable tax laws under subdivision (a)(1) and insert a reference to the FCPL to cover all the taxes and fees currently enacted and administered under the FCPL, as well as eliminate the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL. The recommended amendments to subdivision (a)(1) were also arranged in alphabetical order.

Furthermore, the formal issue paper recommended that the Board propose to amend Regulation 1698, subdivisions (a)(4), (h)(1), and (h)(2) to replace each occurrence of "microfilm or microfiche" with "microfilm, microfiche, PDF files, or other media used in electronic imaging" and propose to amend Regulation 4901 to add "PDF files" to subdivisions (a)(5), (h)(1), and

(h)(2), to address Mr. Jones's submission, which was included as Exhibit 4 to the formal issue paper.

At the conclusion of the Board's discussion of Formal Issue Paper 15-011 during the October 27, 2015, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulations 1698 and 4901 recommended in the formal issue paper. The Board determined that the proposed amendments are reasonably necessary to have the effect and accomplish the objectives of clarifying and updating the regulations to address the issues (or problems) referred to above and respond to Mr. Jones's submission.

The Board anticipates that the proposed amendments to Regulations 1698 and 4901 will benefit business owners that use electronic cash registers, including POS systems, and maintain records in electronic format by providing updated guidance about the electronic records they must maintain and make available to the Board. The Board also anticipates that the amendments to Regulation 4901, subdivision (a)(1), will benefit the Board by eliminating the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL.

The Board has performed an evaluation of whether the proposed amendments to Regulations 1698 and 4901 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulations 1698 and 4901 are the only regulations that specify the types of records that must be maintained and made available for examination on request by the Board under the Sales and Use Tax Law and special tax and fee laws, and the Board is making consistent amendments to both regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulations 1698 and 4901 or the proposed amendments to Regulations 1698 and 4901.

#### **NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that the adoption of the proposed amendments to Regulations 1698 and 4901 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 Regulations 1698 and 4901 will result in no direct or indirect cost or savings to any state agency and will result in no cost or savings in federal funding to the State of California. The Board has also determined that the adoption of the proposed amendments to Regulations 1698 and 4901 result in no direct or indirect cost to any local agency or school district that is required to be reimbursed under part

7 (commencing with section 17500) of division 4 of title 2 of the Government Code, and will result in no other non-discretionary cost or savings imposed on local agencies.

**NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

The Board has made an initial determination that the adoption of the proposed amendments to Regulations 1698 and 4901 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 Regulations 1698 and 4901 may affect small business.

**NO KNOWN 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 determined that the adoption of the proposed amendments to Regulations 1698 and 4901 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, 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 Regulations 1698 and 4901 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 Regulations 1698 and 4901 will not affect the benefits of Regulations 1698 and 4901 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 Regulations 1698 and 4901 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 Pamela Mash, Tax Counsel, by telephone at (916) 323-3248, by e-mail at [Pamela.Mash@boe.ca.gov](mailto:Pamela.Mash@boe.ca.gov), or by mail at State Board of Equalization, Attn: Pamela Mash, 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](mailto: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. Mr. Bennion is the designated backup contact person to Ms. Mash.

## **WRITTEN COMMENT PERIOD**

The written comment period ends at 10:00 a.m. on March 29, 2016, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1698 and 4901 during the March 29-30, 2016, 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 Regulations 1698 and 4901. 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 underscored and strikeout versions of the text of Regulations 1698 and 4901 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 Regulations 1698 and 4901, 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](http://www.boe.ca.gov).

**SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt the proposed amendments to Regulations 1698 and 4901 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 Regulations 1698 and 4901, 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](http://www.boe.ca.gov).

Sincerely,



Joann Richmond, Chief  
Board Proceedings Division

JR:reb

**STATE BOARD OF EQUALIZATION**

BOARD APPROVED



At the March 29, 2016 Board Meeting

Joann Richmond  
Joann Richmond, Chief  
Board Proceedings Division

**Initial Statement of Reasons for  
Proposed Amendments to California Code of Regulations,  
Title 18, Section 1698, *Records*, and Section 4901, *Records***

SPECIFIC PURPOSES, PROBLEMS INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFITS

Current Law

*Sales and Use Tax*

The State Board of Equalization (Board) administers California's sales and use taxes. The Board's Sales and Use Tax Department is responsible for administering the Board's sales and use tax programs, including performing audits to ensure that sales and use taxes are reported properly.

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RTC section 7054 specifies that the Board, or any person authorized in writing by it, "may examine the books, papers, records, and equipment of any person selling tangible personal property and any person liable for the use tax." It further specifies that the Board "may investigate the character of the business of the person in order to verify the accuracy of any return made" or "if no return is made by the person, to ascertain and determine the amount required to be paid."

The Board adopted California Code of Regulations, title 18, section (Regulation) 1698, *Records*, to implement, interpret, and make specific RTC sections 7053 and 7054 by specifying the types of records that must be maintained and made available for examination on request by the Board for sales and use tax purposes. The regulation currently allows records to be maintained and made available in hardcopy or electronic format. The regulation also generally requires all records to be preserved for a period of not less than four years, except for records for reporting periods beginning before January 1, 2003, that are subject to the extended ten year statute of limitations contained in RTC section 7073(d), which the regulation requires to be preserved for a period of not less than ten years. The Board made amendments that substantially updated Regulation 1698 in 1997, and added the provisions regarding records for reporting periods beginning before January 1, 2003, in 2005. However, Regulation 1698 has not been substantially updated since 1997.

As relevant here, Regulation 1698 currently defines the terms “database management system,” “electronic data interchange” or “EDI Technology,” “hardcopy,” and “machine-sensible record.” It explains that machine-sensible records do not include hardcopy records “stored in or by a storage-only imaging system such as microfilm or microfiche.” It also provides the requirements for hardcopy records to be converted to “storage-only imaging media, such as microfilm and microfiche.”

### *Special Taxes and Fees*

The Board also administers a number of special taxes and fees, in addition to the sales and use taxes. As relevant here, those special taxes and fees are administered under the Motor Vehicle Fuel Tax Law (RTC § 7301 et seq.), the Use Fuel Tax Law (RTC § 8601 et seq.), the Cigarette and Tobacco Products Tax Law (RTC § 30001 et seq.), the Alcoholic Beverage Tax Law (RTC § 32001 et seq.), the Energy Resources Surcharge Law (RTC § 40001 et seq.), the Emergency Telephone Users Surcharge Law (RTC § 41001 et seq.), the Hazardous Substances Tax Law (RTC § 43001 et seq.), the Integrated Waste Management Fee Law (RTC § 45001 et seq.), the Oil Spill Response, Prevention, and Administration Fees Law (RTC § 46001 et seq.), the Underground Storage Tank Maintenance Fee Law (RTC § 50101 et seq.), the Fee Collection Procedures Law (FCPL) (RTC § 55001 et seq.), and the Diesel Fuel Tax Law (RTC § 60001 et seq.) (hereafter, collectively referred to as special tax and fee laws).

As relevant here, the Covered Electronic Waste Recycling Fee imposed by Public Resources Code (PRC) section 42464 is administered under the FCPL pursuant to PRC section 42464.2. The California Tire Fee imposed by PRC section 42885 is administered under the FCPL pursuant to PRC section 42882. The Lumber Products Assessment imposed by PRC section 4629.5 is administered under the FCPL pursuant to PRC section 4629.5. The Marine Invasive Species Fee imposed by PRC section 42885 is administered under the FCPL pursuant to RTC sections 44002 and 44003. The Natural Gas Surcharge imposed by Public Utilities Code (PUC) section 890 is administered under the FCPL pursuant to PUC section 893. The Prepaid Mobile Telephony Services Surcharge imposed by RTC section 42010 and Local Charges as defined in RTC section 42101 that are required to be collected by sellers other than direct sellers are administered under the FCPL pursuant to RTC sections 42020 and 42103. And, the Water Rights Fee imposed by Water Code sections 1525 and 13160.1 is administered under the FCPL pursuant to Water Code section 1552.

The Board’s Special Taxes and Fee Department is responsible for administering the Board’s special taxes and fees programs under the special tax and fee laws.

The Board adopted Regulation 4901, *Records*, in 2003 to implement, interpret, and make specific the statutes related to the retention and examination of records under the special tax and fee laws, which are similar to RTC sections 7053 and 7054 (discussed above). (RTC §§ 8301, 8302, 8303, 8304, 9253, 9254, 30453, 30454, 32551, 32453, 40172, 40173, 40174, 40175, 41056, 41073, 41129.30, 43502, 45852, 46602, 46603, 50153, 55302, 60604, 60605, and 60606.) As relevant here, Regulation 4901 contains a list of “Applicable Tax Laws” and prescribes the types of records that must be maintained and made available for examination on request by the Board to determine taxpayers’ and fee payers’ correct liabilities under the

applicable tax laws. Regulation 4901 generally mirrors the provisions of Regulation 1698, except that it provides the requirements for hardcopy records to be converted to “storage-only imaging media, such as *microfilm, microfiche or other media used in electronic imaging.*” (Italics added.)

Regulation 4901 was amended in 2010 to clarify that it applies to the Water Rights Fee (enacted in 2003) and Cover Electronic Waste Recycling Fee (enacted in 2004). However, Regulation 4901 has not been substantially updated since it was adopted in 2003 and does not currently refer to the Lumber Products Assessment and the Prepaid Mobile Telephony Services Surcharge, which were enacted, or Local Charges, which the Board was first required to administer under the FCPL, after the regulation was last amended.

### *Electronic Cash Registers*

Cash registers have existed for many years. They offer business owners an organized place to ring up sales and store money from their sales transactions. Electronic cash registers have also been in use for some time and now include a wide range of devices, such as integrated point-of-sale (POS) systems.

POS systems are sophisticated computer systems that use commercially available operating systems to record each sale when it happens. In recent years, POS systems have become more popular than traditional cash registers with business owners because of their user-friendly interface, data tracking capabilities, and increased affordability. These systems are also popular because they can be integrated with third-party accounting software, online ordering, and credit and debit card processors.

The Legislature added RTC section 7153.6 to the Sales and Use Tax Law (RTC § 6001 et seq.) and RTC section 55363.5 to the FCPL, effective January 1, 2014. (Stats. 2013, ch. 532.) As relevant here, both statutes define the term “electronic cash register” to mean “a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data in whatever manner” and both statutes indicate that electronic cash registers include POS systems.

### Proposed Amendments

#### *Need to Update Regulation 1698*

As new technologies and business practices emerge, the Board must adapt to the new technologies and keep taxpayers informed with relevant guidance using the current terminology in the industry. Board staff determined that there was an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) because Regulation 1698 currently defines the outdated term “machines-sensible record” and generally uses the term to refer to information in an “electronic format,” which is now simply referred to as “electronic records.” Staff determined that there was an issue (or problem) with Regulation 1698 because it does not define the commonly used term electronic cash register or refer to POS systems. Staff also determined that

there was an issue with Regulation 1698 because it did not provide guidance to business owners with POS systems that overwrite data after a period of time about how to maintain their data before it is overwritten.

### *Interested Parties Process*

As a result, the Board's Business Taxes Committee (BTC) staff prepared draft amendments to update Regulation 1698 and address the issues described above, and a discussion paper explaining the draft amendments. Both were provided to interested parties.

Staff's draft amendments to Regulations 1698:

- Defined the term "electronic cash register" and explained that the term includes integrated POS systems.
- Replaced the term "machine-sensible record" with "electronic record" and explained that electronic records included records recorded and maintained by electronic cash registers.
- Changed the format of the example provided in subdivision (c)(2)(A).
- Added an example to subdivision (i) to further explain how business owners should maintain their data if they have POS systems that overwrite data after a period of time.

On June 17, 2015, BTC staff conducted an interested parties meeting to discuss the draft amendments. Following the meeting, staff received a submission, dated July 1, 2015, from Mr. Robert Jones of Collins, Mason & Company LLP. Mr. Jones proposed that each occurrence of "microfilm or microfiche" in the regulation be replaced with "microfilm, microfiche, or pdf."

PDF or "portable document format" is a type of storage-only imaging format that is independent of software, hardware, or operating systems. Invented and developed by Adobe, PDF has become the most popular imaging format since 1994 when Adobe announced that it would provide its Adobe Reader software free online as an open file format. With increased availability and ease of use, PDF files have become the standard for document exchange, almost replacing microfilm or microfiche. Staff agreed with Mr. Jones that PDF is an acceptable record storage format, and as such agreed to add PDF to the regulation where it refers to microfilm and microfiche.

When preparing the second discussion paper and revising the draft amendments to Regulation 1698, BTC staff determined that Regulation 4901 generally mirrors Regulation 1698 (as discussed above). BTC staff also noticed that Regulation 4901 contains language in subdivision (h)(1) and (h)(2) that refers to "microfilm, microfiche or other media used in electronic imaging" (as discussed above). As such, staff revised its draft amendments to Regulation 1698, subdivisions (a)(4), (h)(1), and (h)(2) to replace each occurrence of "microfilm or microfiche" with "microfilm, microfiche, PDF files, or other media used in electronic imaging."

In addition, BTC staff prepared drafted amendments to update Regulation 4901 that mirrored the amendments to Regulation 1698, discussed above, including adding "PDF files" to subdivisions (a)(5), (h)(1), and (h)(2) of Regulation 4901 to ensure consistency between Regulations 1698 and 4901. Also, to further update Regulation 4901, staff drafted amendments to remove the

references to the Marine Invasive Species Fee, California Tire Fee, Natural Gas Surcharge, Covered Electronic Waste Recycling Fee, and Water Rights Fee from subdivision (a)(1)'s list of applicable tax laws and insert a reference to the FCPL to cover all the taxes and fees currently enacted and administered under the FCPL, as well as eliminate the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL.

On August 11, 2015, BTC staff conducted a second interested parties meeting to discuss the draft amendments to Regulations 1698 and 4901. At the meeting, there was overall support for the proposed amendments. Also at the meeting, Mr. Marc Brandeis of Brandeis & Associates, LLC, requested that Excel worksheets and Access databases be included as acceptable forms of records in the regulations. Although staff did not receive a written submission for this request, staff did consider the suggestion. Staff determined that worksheets and database files are not necessarily source data and that they are often summaries or analyses of source data. Staff determined that worksheets and databases are already required to be maintained and made available to the Board under the provisions in subdivision (b)(1)(C) of both regulations, which refer to "schedules or working papers used in connection with the preparation of tax returns." Additionally, staff determined that it would be unnecessarily restrictive to revise the regulation to refer to specific proprietary software products, such as Excel and Access. For these reasons, BTC staff did not agree to incorporate Mr. Brandeis's suggestion into staff's draft amendments.

#### *October 27, 2015, BTC Meeting*

Subsequently, staff prepared Formal Issue Paper 15-011 and distributed it to the Board Members for consideration at the Board's October 27, 2015, BTC meeting. Formal Issue Paper 15-011 recommended that the Board propose to add a definition for "electronic cash register" to subdivision (a)(2) of Regulation 1698 and subdivision (a)(3) of Regulation 4901 to address the second issue (or problem) referred to above. The definitions in the regulations are in alphabetical order, therefore the issue paper recommended that the definition for "electronic cash register" be inserted alphabetically, and the remaining definitions be renumbered.

Subdivision (i) of both regulations explains that records must be kept for a period of not less than four years. The formal issue paper recommended that the Board propose to add an example to this subdivision to address the third issue (or problem) referred to above by explaining that if the taxpayer's POS system periodically overwrites stored data, the taxpayer should transfer and maintain a copy of all the data that would be overwritten or otherwise removed for the specified period.

The formal issue paper recommended that the Board propose to update the term "machine-sensible records" to "electronic records" throughout the regulations to address the first issue (or problem) referred to above. "Machine-sensible records" is an outdated term, and "electronic records" is a current and readily understood term. Board staff also recommended that the Board propose to change the formatting of the regulations in subdivision (c)(2)(A) where they provide examples of what retained records should contain when a taxpayer uses electronic data interchange processes and technology. The recommended amendments reformatted the examples as numbered lists for easier reading and consistent formatting with other subdivisions in the regulations.

Additionally, the formal issue paper recommended that the Board revise Regulation 4901 to remove the references to the Marine Invasive Species Fee, California Tire Fee, Natural Gas Surcharge, Covered Electronic Waste Recycling Fee, and Water Rights Fee from the list of applicable tax laws under subdivision (a)(1) and insert a reference to the FCPL to cover all the taxes and fees currently enacted and administered under the FCPL, as well as eliminate the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL. The recommended amendments to subdivision (a)(1) were also arranged in alphabetical order.

Furthermore, the formal issue paper recommended that the Board propose to amend Regulation 1698, subdivisions (a)(4), (h)(1), and (h)(2) to replace each occurrence of “microfilm or microfiche” with “microfilm, microfiche, PDF files, or other media used in electronic imaging” and propose to amend Regulation 4901 to add “PDF files” to subdivisions (a)(5), (h)(1), and (h)(2), to address Mr. Jones’s submission, which was included as Exhibit 4 to the formal issue paper.

At the conclusion of the Board’s discussion of Formal Issue Paper 15-011 during the October 27, 2015, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulations 1698 and 4901 recommended in the formal issue paper. The Board determined that the proposed amendments are reasonably necessary for the specific purposes of clarifying and updating the regulations to address the issues (or problems) referred to above and respond to Mr. Jones’s submission.

The Board anticipates that the proposed amendments to Regulations 1698 and 4901 will benefit business owners that use electronic cash registers, including POS systems, and maintain records in electronic format by providing updated guidance about the electronic records they must maintain and make available to the Board. The Board also anticipates that the amendments to Regulation 4901, subdivision (a)(1), will benefit the Board by eliminating the need for further revisions to Regulation 4901 when new taxes and fees are enacted that are administered under the FCPL.

The proposed amendments to Regulations 1698 and 4901 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulations 1698 and 4901 or the proposed amendments to Regulations 1698 and 4901.

#### DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 15-011, the exhibits to the issue paper, and the comments made during the Board’s discussion of the issue paper during its October 27, 2015, BTC meeting in deciding to propose the amendments to Regulations 1698 and 4901 described above.

#### ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulations 1698 and 4901 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 Regulations 1698 and 4901 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 Regulations 1698 and 4901 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)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY  
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The proposed amendments to Regulation 1698 and 4901 update and clarify the terms currently used in the regulations, incorporate the statutory definition of electronic cash register, update the guidance currently provided in the regulations regarding storage-only imaging media so that it is clear that such media includes "PDF files" and other media used in electronic imaging, and provide a current example explaining how business owners should maintain their data if they have POS systems that overwrite data after a period of time. The proposed amendments to Regulation 4901 also change the way the regulation refers to taxes and fees administered under the FCPL. The proposed amendments do not mandate that individuals or businesses maintain or make available any records that they are not currently required to maintain or make available or do anything that is not already required by the Sales and Use Tax Law, the special tax and fee laws, or Regulations 1698 and 4901, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action, or that would impact revenue. Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and businesses. And, the Board has determined that the proposed amendments to Regulations 1698 and 4901 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulations 1698 and 4901 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, Regulations 1698 and 4901 do 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 Regulations 1698 and 4901 will not affect the benefits of Regulations 1698 and 4901 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 Regulations 1698 and 4901 will not have a significant adverse economic impact on business.

The proposed amendments to Regulations 1698 and 4901 may affect small businesses.

**Text of Proposed Amendments to  
California Code of Regulations, Title 18, Section 1698**

**1698. Records.**

(a) Definitions.

(1) “Database Management System” - a software system that controls, relates, retrieves, and provides accessibility to data stored in a database.

(2) “Electronic cash register” - a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data. This can include integrated point of sale systems.

~~(23)~~ “Electronic data interchange” or “EDI technology” - the computer to computer exchange of business transactions in a standardized structured electronic format.

~~(3) “Hardcopy” - any document, record, report or other data maintained in a paper format.~~

(4) ~~“Machine-sensible~~Electronic record” - a collection of related information in an electronic, machine-sensible format. ~~Machine-sensible~~Electronic records do not include hardcopy records that are created or recorded on paper or stored in or by a storage-only imaging system such as microfilm, or microfiche, PDF files, or other media used in electronic imaging. Electronic records include records recorded and maintained by electronic cash registers.

(5) “Hardcopy” - any document, record, report or other data maintained in a paper format.

~~(56)~~ “Taxpayer” - every seller or retailer of tangible personal property in this state and every person storing, using or otherwise consuming in this state tangible personal property purchased from a retailer, and every lessor and lessee of tangible personal property for use in this state.

(b) General.

(1) A taxpayer shall maintain and make available for examination on request by the Board or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return. Such records include but are not limited to:

(A) Normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question.

(B) Bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account.

(C) Schedules or working papers used in connection with the preparation of tax returns.

(2) ~~Machine-sensible~~Electronic records are considered records under Revenue and Taxation Code sections 7053 and 7054.

(c) ~~Machine-Sensible~~Electronic Records.

(1) General.

(A) ~~Machine-sensible~~Electronic records used to establish tax compliance shall contain sufficient source document (transaction-level) information so that the details underlying the ~~machine-sensible~~electronic records can be identified and made available to the Board upon request. A taxpayer has discretion to discard duplicated records and redundant information provided the integrity of the audit trail is preserved and the responsibilities under this regulation are met.

(B) At the time of an examination, the retained records must be capable of being retrieved and converted to a standard magnetic record format, e.g., Extended Binary Coded Decimal Interchange Code (EBCDIC) or American Standard Code for Information Interchange (ASCII) flat file.

(C) Taxpayers are not required to construct ~~machine-sensible~~electronic records other than those created in the ordinary course of business. A taxpayer who does not create the electronic equivalent of a traditional paper document in the ordinary course of business is not required to construct such a record for tax purposes.

(2) Electronic Data Interchange Requirements.

(A) Where a taxpayer uses electronic data interchange (EDI) processes and technology, the level of record detail, in combination with other records related to the transactions, must be equivalent to that contained in an acceptable paper record. For example, the retained records should contain such information as:

1. vendor name,
2. invoice date,
3. product description,
4. quantity purchased,
5. price,
6. amount of tax,
7. indication of tax status (e.g., for resale), and
8. shipping detail.

Codes may be used to identify some or all of the data elements, provided the taxpayer maintains a method which allows the Board to interpret the coded information

(B) The taxpayer may capture the information necessary to satisfy subdivision (c)(2)(A) at any level within the accounting system and need not retain the original EDI transaction records provided the audit trail, authenticity, and integrity of the retained records can be established. For example, a taxpayer using EDI technology receives electronic invoices from its suppliers. The taxpayer decides to retain the invoice data from completed and verified EDI transactions in its accounts payable system rather than to retain the EDI transactions themselves. Since neither the EDI transaction nor the accounts payable system capture information from the invoice pertaining to product description and vendor name (i.e., they contain only codes for that information), the taxpayer must also retain other records, such as its vendor master file and product code description lists, and make them available to the Board. In this example, the taxpayer need not retain its EDI transaction for tax purposes.

(3) Electronic Data Processing Systems Requirements. The requirements for an electronic data processing (EDP) accounting system should be similar to that of a manual accounting system, in that an adequately designed accounting system should incorporate methods and records that will satisfy the requirements of this regulation.

(4) Business Process Information.

(A) Upon request of the Board, the taxpayer shall provide a description of the business process that created the retained records. Such description shall include the relationship between the records and the tax documents prepared by the taxpayer and the measures employed to ensure the integrity of the records.

(B) The taxpayer shall be capable of demonstrating:

1. the functions being performed as they relate to the flow of data through the system;
2. the internal controls used to ensure accurate and reliable processing, and;
3. the internal controls used to prevent unauthorized addition, alteration, or deletion of retained records.

(C) The following specific documentation is required for ~~machine-sensible~~ electronic records retained pursuant to this regulation:

1. record formats or layouts;
2. field definitions (including the meaning of all codes used to represent information);
3. file descriptions (e.g., data set name); and

4. detailed charts of accounts and account descriptions.

(d) ~~Machine-Sensible~~Electronic Records Maintenance Requirements.

(1) The taxpayer's computer hardware or software shall accommodate the extraction and conversion of retained ~~machine-sensible~~electronic records to a standard magnetic record format as provided in subdivision (c)(1)(B).

(2) The Board recommends but does not require that taxpayers refer to the National Archives and Record Administration's (NARA) standards for guidance on the maintenance and storage of electronic records, such as the labeling of records, the location and security of the storage environment, the creation of back-up copies, and the use of periodic testing to confirm the continued integrity of the records.

(e) Access to ~~Machine-Sensible~~Electronic Records.

(1) The manner in which the Board is provided access to ~~machine-sensible~~electronic records may be satisfied through a variety of means that shall take into account a taxpayer's facts and circumstances through consultation with the taxpayer.

(2) Such access will be provided in one or more of the following manners:

(A) The taxpayer may arrange to provide the Board with the hardware, software, and personnel resources to access the ~~machine-sensible~~electronic records.

(B) The taxpayer may arrange for a third party to provide the hardware, software, and personnel resources necessary to access the ~~machine-sensible~~electronic records.

(C) The taxpayer may convert the ~~machine-sensible~~electronic records to a standard record format specified by the Board, including copies of files, on a magnetic medium that is agreed to by the Board.

(D) The taxpayer and the Board may agree on other means of providing access to the ~~machine-sensible~~electronic records.

(f) Taxpayer Responsibility and Discretionary Authority.

(1) In conjunction with meeting the requirements of subdivision (c), a taxpayer may create files solely for the use of the Board. For example, if a data base management system is used, it is consistent with this regulation for the taxpayer to create and retain a file that contains the transaction-level detail from the data base management system and that meets the requirements of subdivision (c). The taxpayer should document the process that created the separate file to show the relationship between that file and the original records.

(2) A taxpayer may contract with a third party to provide custodial or management services of the records. Such a contract shall not relieve the taxpayer of its responsibilities under this regulation.

(g) Hardcopy Records.

(1) Except as specifically provided, taxpayers are not relieved of the responsibility to retain hardcopy records that are created or received in the ordinary course of business as required by existing law and regulations. Hardcopy records may be retained on a record keeping medium as provided in subdivision (h).

(2) If hardcopy transaction level documents are not produced or received in the ordinary course of transacting business (e.g., when the taxpayer uses electronic data interchange technology), such hardcopy records need not be created.

(3) Hardcopy records generated at the time of a transaction using a credit or debit card must be retained unless all the details necessary to determine correct tax liability relating to the transaction are subsequently received and retained by the taxpayer in accordance with this regulation. Such details include those listed in subdivision (c)(2)(A).

(4) Computer printouts that are created for validation, control, or other temporary purposes need not be retained.

(h) Alternative Storage Media.

(1) For purposes of storage and retention, taxpayers may convert hardcopy documents received or produced in the normal course of business and required to be retained under this regulation to storage-only imaging media such as microfilm, ~~or~~ microfiche, PDF files, or other media used in electronic imaging and may discard the original hardcopy documents, provided the conditions of this subdivision are met. Documents which may be stored on these media include, but are not limited to general books of account, journals, voucher registers, general and subsidiary ledgers, and supporting records of details, such as sales invoices, purchase invoices, exemption certificates, and credit memoranda.

(2) Storage-only imaging media such as microfilm, ~~and~~ microfiche, PDF files, or other media used in electronic imaging systems shall meet the following requirements.

(A) Documentation establishing the procedures for converting the hardcopy documents to the storage-only imaging system must be maintained and made available on request. Such documentation shall, at a minimum, contain a sufficient description to allow an original document to be followed through the conversion system as well as internal procedures established for inspection and quality assurance.

(B) Procedures must be established for the effective identification, processing, storage, and preservation of the stored documents and for making them available for the period they are required to be retained under subdivision (i).

(C) Upon request by the Board, a taxpayer must provide facilities and equipment for reading, locating, and reproducing any documents maintained on storage-only imaging media.

(D) When displayed on such equipment or reproduced on paper, the documents must exhibit a high degree of legibility and readability. For this purpose, legibility is defined as the quality of a letter or numeral that enables the observer to identify it positively and quickly to the exclusion of all other letters or numerals. Readability is defined as the quality of a group of letters or numerals being recognizable as words or complete numbers.

(E) All data on storage-only imaging media must be maintained and arranged in a manner that permits the location of any particular record.

(F) There is no substantial evidence that the storage-only imaging medium lacks authenticity or integrity.

(i) Record Retention - Time Period. All records required to be retained under this regulation must be preserved for a period of not less than four years unless the State Board of Equalization authorizes in writing their destruction within a lesser period.

For reporting periods beginning before January 1, 2003 that are subject to the extended ten year statute of limitations contained in Revenue and Taxation Code section 7073(d), records required to be retained under this regulation must be preserved for a period of not less than ten years.

For example, if a taxpayer has a point of sale system that overwrites data after a period of time less than four years, the taxpayer should transfer, maintain, and have available, all data that would have been overwritten or otherwise removed from the system for the required time periods indicated above.

(j) Record Retention Limitation Agreements.

(1) The Board has the authority to enter into or revoke a record retention limitation agreement with the taxpayer to modify or waive any of the specific requirements in this regulation. A taxpayer's request for an agreement must specify which records (if any) the taxpayer proposes not to retain and provide the reasons for not retaining such records, as well as; proposing any other terms of the requested agreement. The taxpayer shall remain subject to all requirements of this regulation that are not modified, waived, or superseded by a duly approved record retention limitation agreement.

(A) If a taxpayer seeks to limit its retention of ~~machine-sensible~~ electronic records, the taxpayer may request a record retention limitation agreement, which shall;

1. document understandings reached with the Board, which may include, but is not limited to, any one or more of the following issues:

- a. the conversion of files created on an obsolete computer system;
  - b. restoration of lost or damaged files and the actions to be taken;
  - c. use of taxpayer computer resources, and
2. specifically identify which of the taxpayer's records the Board determines are not necessary for retention and which the taxpayer may discard, and
  3. authorize variances, if any, from the normal provisions of this regulation.

(B) The Board shall consider a taxpayer's request for a record retention limitation agreement and notify the taxpayer of the actions to be taken.

(C) The Board's decision to enter or not to enter into a record retention limitation agreement shall not relieve the taxpayer of the responsibility to keep adequate and complete records supporting entries shown on any tax or information return.

(2) A taxpayer's record retention practices shall be subject to evaluation by the Board when a record retention limitation agreement exists. The evaluation may include a review of the taxpayer's relevant data processing and accounting systems with respect to EDP systems, including systems using EDI technology.

(A) The Board shall notify the taxpayer of the results of any evaluation, including acceptance or disapproval of any proposals made by the taxpayer (e.g., to discard certain records) or any changes considered necessary to bring the taxpayer's practices into compliance with this regulation.

(B) Since the evaluation of a taxpayer's record retention practices is not directly related to the determination of tax reporting accuracy for a particular period or return, an evaluation made under this regulation is not an "examination of records" under section 7054 of the Revenue and Taxation Code.

(C) Unless otherwise specified, an agreement shall not apply to accounting and tax systems added subsequent to the completion of the record evaluation. All ~~machine-sensible~~ electronic records produced by a subsequently added accounting or tax system shall be retained by the taxpayer in accordance with this regulation until a new evaluation is conducted by the Board.

(D) Unless otherwise specified, an agreement made under this subdivision shall not apply to any person, company, corporation, or organization that, subsequent to the taxpayer's signing of a record retention limitation agreement, acquires or is acquired by the taxpayer. All ~~machine-sensible~~ electronic records produced by the acquired or the acquiring person, company, corporation, or organization, shall be retained pursuant to this regulation.

(3) In addition to the record retention evaluation under subdivision (j)(2), the Board may conduct tests to establish the authenticity, readability, completeness, and integrity of the ~~machine-sensible~~ electronic records retained under a record retention limitation agreement. The state shall notify the taxpayer of the results of such tests. These tests may include the testing of EDI and other procedures and a review of the internal controls and security procedures associated with the creation and storage of the records.

(k) Failure to Maintain Records. Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties or other appropriate administrative action

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6455, 7053, ~~and~~ 7054 and 7153.6, Revenue and Taxation Code.

**Text of Proposed Amendments to  
California Code of Regulations, Title 18, Section 4901**

**4901. Records.**

(a) Definitions.

(1) “Applicable Tax Laws” means any of the following:

(A) Aircraft Jet Fuel Tax, Revenue and Taxation Code ~~§~~sections 7385-7398, and 7486-8406;

(B) Alcoholic Beverage Tax, Revenue and Taxation Code ~~§~~sections 32001-32557;

~~(C) Marine Invasive Species Fee, Public Resources Code Sections 71200-71271; Revenue and Taxation Code Sections 44000-44008, 55001-55381;~~

~~(D) California Tire Fee, Public Resources Code Sections 42860-42895; Revenue and Taxation Code Sections 55001-55381;~~

~~(E) Childhood Lead Poisoning Prevention Fee, Health and Safety Code ~~§~~section 105310; Revenue and Taxation Code ~~§~~sections 43001-43651;~~

~~(F) Cigarette and Tobacco Products Tax, Revenue and Taxation Code ~~§~~sections 30001-30481;~~

~~(G) Diesel Fuel Tax, Revenue and Taxation Code ~~§~~sections 60001-60709;~~

~~(H) Emergency Telephone Users Surcharge, Revenue and Taxation Code ~~§~~sections 41001-41176;~~

~~(I) Energy Resources Surcharge, Revenue and Taxation Code ~~§~~sections 40001-40216;~~

(J) Fee Collection Procedures Law, Revenue and Taxation Code sections 55001-55381;

~~(K) Hazardous Substances Tax, Health and Safety Code ~~§~~sections 25174.1, 25205.2, 25205.5, 25205.6, and 25205.7; Revenue and Taxation Code ~~§~~sections 43001-43651;~~

~~(L) Integrated Waste Management Fee, Public Resources Code ~~§~~sections 40000-48008; Revenue and Taxation Code ~~§~~sections 45001-45984;~~

~~(M) Motor Vehicle Fuel Tax, Revenue and Taxation Code ~~§~~sections 7301-8526;~~

~~(N) Natural Gas Surcharge, Public Utilities Code Sections 890-900; Revenue and Taxation Code Sections 55001-55381;~~

~~(O) Occupational Lead Poisoning Prevention Fee, Health and Safety Code ~~§~~section 105190; Revenue and Taxation Code ~~§~~sections 43001-43651;~~

~~(OM)~~ Oil Spill Response, Prevention, and Administration Fees, Revenue and Taxation Code ~~Sections 46001-46751;~~

~~(PN)~~ Underground Storage Tank Maintenance Fee, Revenue and Taxation Code ~~Section 50101-50162; and~~

~~(QO)~~ Use Fuel Tax, Revenue and Taxation Code ~~Sections 8601-9355;.~~

~~(R)~~ Covered Electronic Waste Recycling Fee, Health and Safety Code Sections ~~25214.9-25214.10.2; Public Resources Code Sections 42460-42486; Revenue and Taxation Code Sections 55001-55381;~~

~~(S)~~ Water Rights Fee, Water Code Sections ~~1525-1552, 13050, 13160.1; Revenue and Taxation Code Sections 55001-55381.~~

(2) “Database Management System” - a software system that controls, relates, retrieves, and provides accessibility to data stored in a database.

(3) “Electronic cash register” - a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data. This can include integrated point of sale systems.

~~(34)~~ “Electronic data interchange” or “EDI technology” - the computer to computer exchange of business transactions in a standardized structured electronic format.

~~(4) “Hardcopy” - any document, record, report or other data maintained in a paper format.~~

(5) “Machine-sensibleElectronic record” - a collection of related information in an electronic, machine-sensible format. Machine-sensibleElectronic records do not include hardcopy records that are created or recorded on paper or stored in or by a storage-only imaging system such as microfilm, or microfiche, PDF files, or other media used in electronic imaging. Electronic records include records recorded and maintained by electronic cash registers.

~~(6) “Hardcopy” - any document, record, report or other data maintained in a paper format.~~

~~(67)~~ “Taxpayer” includes “fee payer” and means any person liable for the payment of a tax or a fee specified under any of the applicable tax laws.

~~(78)~~ “Tax” includes “fee” and means any amount of tax or fee specified under any of the applicable tax laws.

(b) General.

(1) A taxpayer shall maintain and make available for examination on request by the ~~h~~Board or its authorized representative, all records necessary to determine the correct tax liability under the applicable tax laws and all records necessary for the proper completion of the required tax return or report. Such records include but are not limited to:

(A) Books of account or other similar summary information ordinarily maintained by the taxpayer as required by law or practice or otherwise in the possession of the taxpayer or third party at the direction or request of the taxpayer.

(B) Bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account.

(C) Schedules or working papers used in connection with the preparation of tax returns and reports.

(2) ~~Machine-sensible~~Electronic records are considered records under Revenue and Taxation Code Sections 8301-8306, 9253, 9254, 30453, 30454, 32551, 32453, 40172-40175, 41056, 41073, 41129.30, 43502, 45852, 46602, 46603, 50153, 55302, and 60604-60606, ~~Revenue and Taxation Code.~~

(c-) ~~Machine-Sensible~~Electronic Records.

(1) General.

(A) ~~Machine-sensible~~Electronic records used to establish tax compliance shall contain sufficient source document (transaction-level) information so that the details underlying the ~~machine-sensible~~electronic records can be identified and made available to the ~~h~~Board upon request. A taxpayer has discretion to discard duplicated records and redundant information provided the integrity of the audit trail is preserved and the responsibilities under this regulation are met.

(B) At the time of an examination, the retained records must be capable of being retrieved and converted to a standard magnetic record format which the ~~h~~Board has the technological capability to use, such as Extended Binary Coded Decimal Interchange Code (EBCDIC) or American Standard Code for Information Interchange (ASCII) flat file.

(C) Taxpayers are not required to construct ~~machine-sensible~~electronic records other than those created in the ordinary course of business. A taxpayer who does not create the electronic equivalent of a traditional paper document in the ordinary course of business is not required to construct such a record for tax purposes.

(2) Electronic Data Interchange Requirements.

(A) Where a taxpayer uses electronic data interchange (EDI) processes and technology, the level of record detail, in combination with other records related to the transactions,

must be equivalent to that contained in an acceptable paper record. For example, the retained records should contain such information as:

1. vendor name,
2. invoice date,
3. product description,
4. quantity purchased,
5. price,
6. amount of tax,
7. indication of tax status (e.g., exempt), and
8. shipping detail.

Codes may be used to identify some or all of the data elements, provided the taxpayer maintains a method which allows the bBoard to interpret the coded information.

(B) The taxpayer may capture the information necessary to satisfy subdivision (c)(2)(A) at any level within the accounting system and need not retain the original EDI transaction records provided the audit trail, authenticity, and integrity of the retained records can be established. For example, a taxpayer using EDI technology receives electronic invoices from its suppliers. The taxpayer decides to retain the invoice data from completed and verified EDI transactions in its accounts payable system rather than to retain the EDI transactions themselves. Since neither the EDI transaction nor the accounts payable system capture information from the invoice pertaining to product description and vendor name (i.e., they contain only codes for that information), the taxpayer must also retain other records, such as its vendor master file and product code description lists, and make them available to the bBoard. In this example, the taxpayer need not retain its EDI transaction for tax purposes.

(3) Electronic Data Processing Systems Requirements. The requirements for an electronic data processing (EDP) accounting system should be similar to that of a manual accounting system, in that an adequately designed accounting system should incorporate methods and records that will satisfy the requirements of this regulation.

(4) Business Process Information.

(A) Upon request of the bBoard, the taxpayer shall provide a description of the business process that created the retained records. Such description shall include the relationship between the records and the tax documents prepared by the taxpayer and the measures employed to ensure the integrity of the records.

(B) The taxpayer shall be capable of demonstrating:

1. the functions being performed as they relate to the flow of data through the system;
2. the internal controls used to ensure accurate and reliable processing, and;
3. the internal controls used to prevent unauthorized addition, alteration, or deletion of retained records.

(C) The following specific documentation is required for ~~machine-sensible~~electronic records retained pursuant to this regulation:

1. record formats or layouts;
2. field definitions (including the meaning of all codes used to represent information);
3. file descriptions (e.g., data set name); and
4. detailed charts of accounts and account descriptions.

(d) ~~Machine-Sensible~~Electronic Records Maintenance Requirements

(1) The taxpayer's computer hardware or software shall accommodate the extraction and conversion of retained ~~machine-sensible~~electronic records to a standard magnetic record format as provided in subdivision (c)(1)(B).

(2) The ~~b~~Board recommends but does not require that taxpayers refer to the National Archives and Record Administration's (NARA) standards for guidance on the maintenance and storage of electronic records, such as the labeling of records, the location and security of the storage environment, the creation of back-up copies, and the use of periodic testing to confirm the continued integrity of the records.

(e) Access to ~~Machine-Sensible~~Electronic Records.

(1) The manner in which the ~~b~~Board is provided access to ~~machine-sensible~~electronic records may be satisfied through a variety of means that shall take into account a taxpayer's facts and circumstances through consultation with the taxpayer.

(2) Such access will be provided in one or more of the following manners:

(A) The taxpayer may arrange to provide the ~~b~~Board with the hardware, software, and personnel resources to access the ~~machine-sensible~~electronic records.

(B) The taxpayer may arrange for a third party to provide the hardware, software, and personnel resources necessary to access the ~~machine-sensible~~electronic records.

(C) The taxpayer may convert the ~~machine-sensible~~ electronic records to a standard record format specified by the ~~b~~Board, including copies of files, on a magnetic medium that is agreed to by the ~~b~~Board.

(D) The taxpayer and the ~~b~~Board may agree on other means of providing access to the ~~machine-sensible~~ electronic records.

(f) Taxpayer Responsibility and Discretionary Authority.

(1) In conjunction with meeting the requirements of subdivision (c), a taxpayer may create files solely for the use of the ~~b~~Board. For example, if a data base management system is used, it is consistent with this regulation for the taxpayer to create and retain a file that contains the transaction-level detail from the data base management system and that meets the requirements of subdivision (c). The taxpayer should document the process that created the separate file to show the relationship between that file and the original records.

(2) A taxpayer may contract with a third party to provide custodial or management services of the records. Such a contract shall not relieve the taxpayer of its responsibilities under this regulation.

(g) Hardcopy Records.

(1) Except as specifically provided, taxpayers are not relieved of the responsibility to retain hardcopy records that are created or received in the ordinary course of business as required by existing law and regulations. Hardcopy records may be retained on a record keeping medium as provided in subdivision (h).

(2) If hardcopy transaction level documents are not produced or received in the ordinary course of transacting business (e.g., when the taxpayer uses electronic data interchange technology), such hardcopy records need not be created.

(3) Hardcopy records generated at the time of a transaction using a credit or debit card must be retained unless all the details necessary to determine correct tax liability relating to the transaction are subsequently received and retained by the taxpayer in accordance with this regulation. Such details include those listed in subdivision (c)(2)(A).

(4) Computer printouts that are created for validation, control, or other temporary purposes need not be retained.

(h) Alternative Storage Media.

(1) For purposes of storage and retention, taxpayers may convert hardcopy documents received or produced in the normal course of business and required to be retained under this regulation to storage-only imaging media such as microfilm, microfiche, PDF files, or other media used in electronic imaging and may discard the original hardcopy documents, provided the conditions of subdivision (h) are met. Documents which may be stored on these

media include, but are not limited to general books of account, journals, voucher registers, general and subsidiary ledgers, and supporting records of details, such as sales invoices, purchase invoices, exemption certificates, and credit memoranda.

(2) Storage-only imaging media such as microfilm, microfiche, PDF files, or other media used in electronic imaging systems shall meet the following requirements.

(A) Documentation establishing the procedures for converting the hardcopy documents to the storage-only imaging system must be maintained and made available on request. Such documentation shall, at a minimum, contain a sufficient description to allow an original document to be followed through the conversion system as well as internal procedures established for inspection and quality assurance.

(B) Procedures must be established for the effective identification, processing, storage, and preservation of the stored documents and for making them available for the period they are required to be retained under subdivision (i).

(C) Upon request by the Board, a taxpayer must provide facilities and equipment for reading, locating, and reproducing any documents maintained on storage-only imaging media.

(D) When displayed on such equipment or reproduced on paper, the documents must exhibit a high degree of legibility and readability. For this purpose, legibility is defined as the quality of a letter or numeral that enables the observer to identify it positively and quickly to the exclusion of all other letters or numerals. Readability is defined as the quality of a group of letters or numerals being recognizable as words or complete numbers.

(E) All data on storage-only imaging media must be maintained and arranged in a manner that permits the location of any particular record.

(F) There is no substantial evidence that the storage-only imaging medium lacks authenticity or integrity.

(i) Record Retention - Time Period. All records required to be retained under this regulation must be preserved for a period of not less than four years unless the State Board of Equalization authorizes in writing their destruction within a lesser period.

For example, if a taxpayer has a point of sale system that overwrites data after a period of time less than four years, the taxpayer should transfer, maintain, and have available, all data that would have been overwritten or otherwise removed from the system for the required time periods indicated above.

(j) Record Retention Limitation Agreements.

(1) The hBoard has the authority to enter into or revoke a record retention limitation agreement with the taxpayer to modify or waive any of the specific requirements in this regulation. A taxpayer's request for an agreement must specify which records (if any) the taxpayer proposes not to retain and provide the reasons for not retaining such records, as well as, proposing any other terms of the requested agreement. The taxpayer shall remain subject to all requirements of this regulation that are not modified, waived, or superseded by a duly approved record retention limitation agreement.

(A) If a taxpayer seeks to limit its retention of ~~machine-sensible~~ electronic records, the taxpayer may request a record retention limitation agreement, which shall;

1. document understandings reached with the hBoard, which may include, but is not limited to, any one or more of the following issues:

- a. the conversion of files created on an obsolete computer system;
- b. restoration of lost or damaged files and the actions to be taken;
- c. use of taxpayer computer resources, and

2. specifically identify which of the taxpayer's records the hBoard determines are not necessary for retention and which the taxpayer may discard, and

3. authorize variances, if any, from the normal provisions of this regulation.

(B) The hBoard shall consider a taxpayer's request for a record retention limitation agreement and notify the taxpayer of the actions to be taken.

(C) The hBoard's decision to enter or not to enter into a record retention limitation agreement shall not relieve the taxpayer of the responsibility to keep adequate and complete records supporting entries shown on any tax or information return.

(2) A taxpayer's record retention practices shall be subject to evaluation by the hBoard when a record retention limitation agreement exists. The evaluation may include a review of the taxpayer's relevant data processing and accounting systems with respect to EDP systems, including systems using EDI technology.

(A) The hBoard shall notify the taxpayer of the results of any evaluation, including acceptance or disapproval of any proposals made by the taxpayer (e.g., to discard certain records) or any changes considered necessary to bring the taxpayer's practices into compliance with this regulation.

(B) Since the evaluation of a taxpayer's record retention practices is not directly related to the determination of tax reporting accuracy for a particular period or return, an evaluation made under this regulation is not an "examination of records" under the applicable tax law.

(C) Unless otherwise specified, an agreement shall not apply to accounting and tax systems added subsequent to the completion of the record evaluation. All ~~machine-sensible~~ electronic records produced by a subsequently added accounting or tax system shall be retained by the taxpayer in accordance with this regulation until a new evaluation is conducted by the ~~h~~Board.

(D) Unless otherwise specified, an agreement made under this subdivision shall not apply to any person, company, corporation, or organization that, subsequent to the taxpayer's signing of a record retention limitation agreement, acquires or is acquired by the taxpayer. All ~~machine-sensible~~ electronic records produced by the acquired or the acquiring person, company, corporation, or organization, shall be retained pursuant to this regulation.

(3) In addition to the record retention evaluation under subdivision (j)(2), the ~~h~~Board may conduct tests to establish the authenticity, readability, completeness, and integrity of the ~~machine-sensible~~ electronic records retained under a record retention limitation agreement. The state shall notify the taxpayer of the results of such tests. These tests may include the testing of EDI and other procedures and a review of the internal controls and security procedures associated with the creation and storage of the records.

(k) Failure to Maintain Records. Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties or other appropriate administrative action.

Note: Authority cited: Sections 8251, 9251, 30451, 32451, 40171, 41128, 43501, 45851, 46601, 50152, 55301 and 60601, Revenue and Taxation Code. Reference: Sections 8301, 8302, 8303, 8304, 9253, 9254, 30453, 30454, 32551, 32453, 40172, 40173, 40174, 40175, 41056, 41073, 41129.30, 43502, 45852, 46602, 46603, 50153, 55302, 55363.5, 60604, 60605 and 60606, Revenue and Taxation Code.

## Regulation History

**Type of Regulation:** Sales and Use Tax and Special Taxes and Fees

Regulation: 1698, 4901

Title: 1698 *Records*

*4901 Records*

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The State Board of Equalization proposes to adopt amendments to define the term electronic cash register, update the terminology used to refer to electronic records, and clarify taxpayers' record retention requirements.

### History of Proposed Regulation:

March 29-30, 2016	Public Hearing
January 29, 2016	OAL publication date; 45-day public comment period begins; Interested Parties mailing
January 19, 2016	Notice to OAL
October 27, 2015	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor: NA

Support: NA

Oppose: NA