



STATE BOARD OF EQUALIZATION

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November 6, 2009

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the November 17, 2009 Business Taxes Committee meeting. This meeting will address the proposed Regulation 1698.5, *Audit Procedures*. Action 1 on the Agenda concerns proposed new Regulation 1698.5 which would incorporate general sales and use tax auditing procedures into a regulation.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue papers, minutes, a procedures manual, and a materials preparation and review schedule arranged according to subject matter and meeting date.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **November 17, 2009**, in Room 121 at the address shown above.

Sincerely,

Randie L. Henry, Deputy Director
Sales and Use Tax Department

RLH: llw

Enclosures

cc: (all with enclosures)

Honorable Betty T. Yee, Chairwoman, First District (MIC 71)
Honorable Jerome E. Horton, Vice-Chair, Fourth District
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Michelle Steel, Member, Third District
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel (via e-mail)

Mr. Alan LoFaso, Board Member's Office, First District
Mr. Gary Qualset, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Amber Kemp, Board Member's Office, First District
Ms. Regina Evans, Board Member's Office, Fourth District
Mr. Doug Anderson, Board Member's Office, Fourth District
Mr. Steve Shea, Board Member's Office Fourth District
Mr. Lee Williams, Board Member's Office, Second District
Mr. Ken Maddox, Board Member's Office, Third District
Mr. Neil Shah, Board Member's Office, Third District
Ms. Elizabeth Maeng, Board Member's Office, Third District
Ms. Christina Rueck, Board Member's Office, Third District
Ms. NaTasha Ralston Ratcliff, State Controller's Office
Mr. Ramon J. Hirsig
Ms. Kristine Cazadd
Ms. Randie L. Henry
Mr. Jeff Vest
Mr. Randy Ferris
Mr. David Levine
Mr. Timothy Treichelt
Mr. Robert Tucker
Mr. Andrew Kwee
Mr. Todd Gilman
Ms. Laureen Simpson
Mr. Robert Ingenito Jr.
Ms. Freda Orendt
Mr. Stephen Rudd
Mr. Kevin Hanks
Mr. Jeffrey McGuire
Mr. James Kuhl
Mr. Geoffrey E. Lyle
Ms. Leila Hellmuth
Ms. Lynn Whitaker
Ms. Lynda Cardwell

AGENDA — November 17, 2009 Business Taxes Committee Meeting
Proposed regulation for audit procedures in general

<p>Action 1 — Proposed Regulation 1698.5, <i>Audit Procedures</i></p> <p>Issue Paper Alternative 1 – Staff Recommendation Agenda, page 2</p> <p>Issue Paper Alternative 2 – No regulation</p>	<p>Approve and authorize publication of proposed Regulation 1698.5.</p> <p style="text-align: center;">OR</p> <p>Do not approve proposed Regulation 1698.5.</p>
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AGENDA — November 17, 2009 Business Taxes Committee Meeting
Proposed regulation for audit procedures in general

<p>Action 1 — Proposed Regulation 1698.5</p>	<p><u>Regulation 1698.5. AUDIT PROCEDURES</u></p> <p><u>(a) DEFINITIONS.</u></p> <p><u>(1) BOARD. For the purposes of this regulation, “Board” refers to the Board of Equalization.</u></p> <p><u>(2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer’s representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.</u></p> <p><u>(3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer’s representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.</u></p> <p><u>(4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer’s representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.</u></p> <p><u>(5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer’s representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.</u></p> <p><u>(6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.</u></p> <p><u>(7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff’s findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.</u></p> <p><u>(8) RECORDS. For the purposes of this regulation, “records” includes all records, including electronic (machine-sensible) 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 as provided in Regulation 1698.</u></p> <p><u>(9) DAY. For the purposes of this regulation, “day” means calendar day.</u></p> <p><u>(b) GENERAL.</u></p> <p><u>The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for</u></p>
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Proposed regulation for audit procedures in general

appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

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	<p><u>(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(8) of this regulation.</u></p> <p><u>(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation, and provide the resources to do so.</u></p> <p><u>(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.</u></p> <p><u>(H) Inform the taxpayer of the audit findings at the exit conference.</u></p> <p><u>(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.</u></p> <p><u>(J) Safeguard taxpayers' records while examining them.</u></p> <p><u>(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.</u></p> <p><u>(5) Duty of Taxpayers.</u></p> <p><u>(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.</u></p> <p><u>(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation; and provide adequate resources to do so.</u></p> <p><u>(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.</u></p> <p><u>(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.</u></p> <p><u>(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.</u></p> <p><u>(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.</u></p> <p><u>(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue</u></p>
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and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

(c) AUDITS.

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to

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attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Claims for Refund. Taxpayers or their representatives should present claims for refund at the beginning of the audit. A claim for refund that is presented near the conclusion of the audit may be addressed separately so as not to delay the timely completion of the current audit.

(8) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(9) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSS, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

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(10) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(11) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to

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the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(12) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Issue Paper Number **09-005**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposed regulation for audit procedures in general

I. Issue

Should a new regulation be adopted that would outline general audit procedures?

II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given our limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board of Equalization staff.

III. Other Alternative Considered

Do not approve proposed Regulation 1698.5. The following interested parties submitted comments recommending the Board not approve the proposed regulation: Mr. Michael Wang, Western States Petroleum Association; Mr. Joseph Vinatieri, Bewley, Lasseben & Miller; Mr. Dan Davis, Associated Sales Tax Consultants; Mr. Norman Jung, BDO Seldman; Ms. Michele Pielsticker, California Taxpayers' Association, California Bankers Association, California Chamber of Commerce, California Manufacturers and Technology Association, and TechAmerica; Ms. Katherine Negggers, General Electric Company; Mr. Dennis Brown, Equipment Leasing and Finance Association; Ms. Pamela Sederholm, American Automotive Leasing Association; Mr. Randall McCathren, Association of Consumer Vehicle Lessors; and Ms. Jana Leslie, Council on State Taxation.

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IV. Background

Revenue and Taxation Code sections 7053 and 7054 provide that California sellers, retailers, and persons purchasing property for storage, use, or consumption in California are required to maintain records and provide those records to the Board for verification of amounts required to be paid to the Board. The objective of a sales and use tax audit is to determine, with the least possible expenditure of time, the accuracy of any return made or the amount required to be paid. Although the Board's audit manual provides detailed procedures and techniques for verifying amounts reported on sales and use tax returns, the Board does not have a regulation on audit procedures.

Staff met with interested parties on February 3, 5 and 10, 2009; June 2, 2009; and August 4 and 6, 2009, to discuss proposed Regulation 1698.5. The issue is scheduled for discussion at the November 17, 2009, meeting of the Business Taxes Committee.

V. Discussion

Because sales and use taxes are self-assessed by taxpayers, the Board's audit program is essential to ensure that the tax is being enforced uniformly, to deter tax evasion and carelessness in self-assessments, and to promote accuracy in self-assessments with respect to the interpretation of the law. Staff and interested parties have worked together to address concerns and clarify the proposed regulatory language; however, many issues remain unresolved.

Need for the proposed regulation. Interested parties commented that staff has not demonstrated a need for the regulation, and that the imprecise nature of the proposed language is out of place in a regulation. Providing that "in general, a procedure will be x" is vague and likely will lead to disputes with taxpayers over how to interpret terms, ultimately resulting in litigation. They conclude that while some degree of flexibility is desirable, a regulation has the force and effect of law, and such flexibility is better placed in the Board's audit manual.

Staff disagrees. Although the Board's audit manual is available to the public, it is primarily an advisory resource providing guidance to Board staff. Audit procedures formalized in a regulation are clearly intended to guide Board staff and taxpayers. Regulations are also more accessible to the public. Because the regulation provides consistent definitions and procedures, people with various levels of expertise can navigate through the sometimes complex audit process.

Staff recognizes that all audits are different and intentionally drafted its proposal so that auditors use their judgment in applying the regulation to the facts and circumstances of any particular audit. Auditors have the duty to exercise professional judgment and expertise throughout the audit process and will continue to carry out that duty in applying the provisions of the regulation. Auditors currently decide how to test reported transactions, the materiality of an audit area, and how much time to allow taxpayers to provide records. An overly prescriptive regulation would undesirably restrict both taxpayers and staff. Staff believes the proposed regulation is necessary to improve audit efficiency and believes this improvement will accelerate revenue collection.

Two-year timeframe for completing audits. Board staff completes most audits within a few months; however, complicated audits can take longer. Staff believes that by working cooperatively with taxpayers, most audits can be completed in two years. Staff has included this goal in subdivision (c)(8):

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“. . . To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted. . . .”

The two-year timeframe does not include the pre-audit conference time for staff and the taxpayer to discuss the availability and production of records, including electronic records.

Interested parties commented that it is unreasonable to expect large audits to be completed in two years. The only way for many companies to achieve a two-year completion would be to dedicate an exorbitant amount of state and taxpayer resources. These costs would outweigh any benefit from an expedited audit of a taxpayer. Interested parties further commented that field auditors trying to meet the two-year timeframe probably would not allow taxpayers additional time to provide records to resolve audit issues in the field and as a result, there will likely be an increase in audit appeals.

Staff believes that with the proposed improvements to audit processes, such as pre-audit conferences and the inclusion of timeframes for both taxpayers and staff in the Information/Document Request and Audit Findings Presentation Sheet processes, the goal of completing an audit within two years is feasible. However, in recognition that not all audits will meet this standard, staff’s proposed regulatory language clearly shows that the two-year timeframe is a goal and not a requirement.

Concurrent audits. Staff believes in most audit situations it is beneficial to proceed with a subsequent audit even though the prior audit is still in process or under appeal. Accordingly, subdivision (c)(4) provides in the second paragraph:

“Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal or a prior audit currently in the Board’s appeal process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of an appeal.”

Interested parties commented that it is unreasonable to conduct an audit when a significant amount of time and effort might be saved resulting from the outcome of an appeal or audit in progress. Many times when an older audit is concluded, the taxpayer and the auditor will agree to apply the results of the audit to future periods. This practice saves resources for both the taxpayer and the state. In other cases, the audit involves a significant legal issue that the taxpayer believes can be resolved by the Appeals Division or the Board. Again, the effect of proceeding with the subsequent audit will be to push through an audit even though with a reasonable wait period, the subsequent audit could be resolved without a substantial outlay of time and money on both the part of the state and the taxpayer.

Staff believes that it is generally better not to delay audits, as it is more difficult for taxpayers to provide older records (changes in the taxpayer’s recordkeeping software, accounting staff, and record storage systems are more likely as time passes). It is also more difficult for taxpayers to support non-taxable transactions with third parties the longer an audit is delayed. For example, if a taxpayer sends letters to customers to support claimed resale transactions, it is generally easier if the transactions are recent.

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Proceeding with a subsequent audit also means that areas of the audit not under contention can be verified as accurately reported or determined if underreported. The taxpayer will also know the amount of the possible liability for audit areas under dispute. In this way, taxpayers can pay the liability they agree with and decide if they want to pre-pay any disputed liability to stop interest from accruing. This may be particularly important in appeal cases where it may take several months or even years to resolve the case.

Staff agrees that audits can require a substantial amount of taxpayer resources, and believes that starting the subsequent audit field work with areas unaffected by the outcome of the prior audit or appeal may alleviate some of interested parties concerns, as the issue may be resolved before the subsequent audit is completed. Staff would also like to note that accounts are not routinely assigned for subsequent audits; accounts are selected and assigned after consideration of many factors. When reporting errors are found in an audit, the account is generally selected for the next audit period to ensure that those errors were corrected. If an error still exists, the auditor may be able to use a percentage of error developed from the prior audit to estimate liability in the current audit. Procedures for the use of prior audit percentages are included in Audit Manual section 0405.33. Separate from the proposed regulation issue, the Sales and Use Tax Department will issue a policy memo to remind and encourage audit staff to use prior audit percentages whenever the situation qualifies and the taxpayer agrees.

Although interested parties commented that beginning subdivision (c)(4) with the word “generally” could result in inconsistent application and excessive auditor discretion, staff added the term so that the provision to not hold a subsequent audit in abeyance is not absolute. That is, staff could hold the start of a subsequent audit when both the taxpayer and staff agree. However, staff believes the decision whether to hold or proceed with a subsequent audit is the responsibility of Board audit staff.

Information/Document Request (IDR) process. Proposed Regulation 1698.5 includes an IDR process to be used when the taxpayer is unresponsive to the auditor’s verbal requests for records. The auditor has the discretion to determine response times for verbal requests. Currently under development, IDRs are Board forms used to request single or multiple documents from the taxpayer (see Exhibit 3). The IDR process includes sending an initial IDR, a second IDR, and a formal notice and demand to furnish information. This process is similar to the record request process included in current Audit Manual section 0401.25, except that it includes timeframes for IDR responses. Staff believes incorporating these timeframes formalizes the existing process and will improve the consistency in how records are requested. The IDR process allows taxpayers the following number of days to provide records (unless a period of the audit will expire under the statute of limitations):

- 30 days for the first IDR,
- 15 days for the second IDR, and
- 15 days for the formal notice and demand before staff may issue a subpoena for records or issue a determination based on an estimate.

The process also provides that any response other than full compliance with the initial IDR will be reviewed by the District Principal Auditor who will determine the course of action to be taken in response to any issues raised by the taxpayer. When an auditor receives records in response to an IDR, the auditor will have 30 days to notify the taxpayer whether the documents provided are sufficient or if additional information is needed.

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Some interested parties commented that a 30-day response time for an IDR is not reasonable. Much of the audit fieldwork is centered on reviewing thousands of transactions that have occurred during the audit period – even on a statistical sample basis there are numerous transactions to be reviewed and documents to support the transactions. The proposed process ignores the detailed nature of a sales and use tax audit.

Staff notes that the IDR process is only used when the taxpayer does not respond to verbal requests for records. Auditors and taxpayers are expected to work cooperatively to allow the taxpayer sufficient time to provide records before the IDR process begins.

Audit Findings Presentation Sheet (AFPS) Process. Also under development, AFPSs are Board forms used to present staff's findings for each area of the audit as it is completed (see Exhibit 4). The audit working paper lead and subsidiary schedules will be attached to AFPSs; comments on the AFPS forms do not take the place of verification comments on audit working papers. The purpose of the AFPS process is to keep taxpayers informed about, and document, the status of the audit as it proceeds.

Taxpayers will generally have 30 days from the date the AFPS is provided to indicate whether they agree or disagree with the proposed findings and to provide additional information to rebut the findings if they disagree. The proposed regulation explains that a taxpayer's agreement with the audit findings on the AFPS does not preclude the taxpayer from protesting or appealing the issues at a later date. As a general rule, within 30 days of receiving the additional information, the auditor will notify the taxpayer if an adjustment to the audit is warranted based on the information provided.

Interested parties commented that the AFPS provision seems to require the taxpayer to formulate a defense during the course of the audit which might impact a subsequent appeal of the audit after its closure. Taxpayers need time to consult with legal counsel and gather necessary information before formulating a position with respect to certain portions of the audit. The AFPS also appears to be duplicative of the audit working papers, and seems to conflict with the taxpayer's right to respond to the total audit determination at the close of the audit.

Staff believes that combined with routine audit status conferences, the AFPS process will keep taxpayers informed and document the status of their audit. By making taxpayers aware of possible liability during the audit rather than at the end of the audit, taxpayers will have more time to provide information that rebuts the audit findings. Taxpayers are also provided an earlier time to pre-pay audit liabilities they do not dispute.

Duty of Board staff to request information. Auditors must request records in order to ascertain whether the correct amount of tax was reported. Interested parties expressed concerns that earlier versions of the proposed regulation did not protect taxpayers from overreaching auditors, including auditors who want direct access to the taxpayer's computer system. Interested parties also recommended that the proposed regulation specifically address the issue of providing electronic records in the format determined by the Board.

To address these concerns, staff added a definition of "records" [subdivision (a)(8)] referring to the records required in Regulation 1698, *Records*. Staff also revised subdivision (b)(4)(C) to refer to Regulation 1698 and to explain that staff will work with the taxpayer to resolve difficulties the taxpayer may have when responding to Board information requests, including the use of satisfactory alternative sources of information. Staff does not believe a specific provision is needed in proposed Regulation 1698.5 for electronic records as Regulation 1698 already addresses machine-sensible (electronic) records. With regard to direct access to a taxpayer's computer system, staff added

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subdivision (b)(4)(D) to provide that staff will not directly access a taxpayer's computer system if the taxpayer objects to such access except in the case of a search warrant.

Duty of taxpayer to make records available for photocopying or scanning. Subdivision (b)(5)(C) provides that the Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transactions. Staff included this provision since including copies of questioned invoices, resale certificates, contracts, etc. in the audit working papers can be useful in showing why a nontaxable transaction was disallowed.

Interested parties explained that some taxpayers may have legitimate business policies to forbid any scanned or photocopied documents from leaving the business premises. These reasons could include contractual obligations or national security obligations imposed by federal agencies. In response to this concern, staff revised its proposed language to provide that taxpayers may be required to make records available for photocopying or scanning, unless otherwise prohibited by federal law. Staff notes, however, that the taxpayer may still have to make these records available for staff's review in order to support a non-taxable transaction.

Duty of taxpayers to provide adequate resources. Subdivision (b)(5)(B) provides that taxpayers have the duty to provide adequate resources in order to adhere to the timelines provided in the audit plan. This provision mirrors subdivision (b)(4)(F), which provides that Board staff has the duty to provide adequate resources to adhere to the timelines in the audit plan. Staff added these provisions to show that audits are a cooperative effort requiring resources from Board staff and taxpayers.

Some interested parties commented that the Revenue and Taxation Code requires taxpayers to make records available for review, not that taxpayers make employees available to help auditors complete their assignments on time. Outside of the customary communications between taxpayers or representatives and auditors that have always been part of the audit process, the Board is not (and should not be) empowered to require a taxpayer to commit staff to an audit for any purpose. A government agency does not have the authority to tell a taxpayer how many employees the taxpayer's tax department should have and what they should be working on.

Again, staff believes audits are cooperative efforts and the regulation should reflect that both staff and taxpayers have the duty to meet the agreed upon timeframes.

Location of audits. Subdivision (c)(1) provides that audits generally take place where the taxpayer's books and records are maintained, usually the taxpayer's place of business. Taxpayers can request that the audit take place at a different location, however, it is the taxpayer's responsibility to provide all requested records at that location. The subdivision explains that reasonable requests to move an audit to another location will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location. Staff included this provision to prevent unnecessary delays in the audit or situations where requested changes in locations may only impede the progress of an audit.

Some interested parties expressed concern that the proposed provisions are a step backward from the existing practice which allows taxpayers to determine the location of an audit if adequate books and records are provided to Board staff at that location. The provisions give too much discretion to Board staff to deny taxpayers the ability to undergo an audit at the taxpayer's most convenient location.

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Staff disagrees, as the reasons for not granting the request are explained and narrow in scope.

Audit plan. Subdivision (c)(8) provides that an audit plan is required on all audits and that the audit plan document the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. The audit plan is to be discussed with the taxpayer and a copy provided at the beginning of the audit. The plan should be signed by the auditor and the taxpayer to show a commitment by both parties that the audit will be conducted in the manner discussed. Changes to the plan may occur if the auditor discovers a previously unknown area requiring review, or determines that a taxpayer needs additional time to provide records or information about questioned transactions. If the original audit plan is amended, the auditor will provide the taxpayer with a copy of the amended plan.

Some interested parties contend that it should be made clear that the audit plan is not binding and the taxpayer is not compelled to agree with it. The use of the word “commitment” causes concern that the audit plan may be used to force a taxpayer into an unfavorable audit methodology. Taxpayers should not be compelled to agree with the plan or proposed methodology; a signature should indicate only that the taxpayer has read and understands the plan.

Again, staff believes that having taxpayers sign the audit plan shows that audits are a cooperative effort between Board staff and taxpayers.

Waiver of Limitation. In response to interested party comments about the waiver of limitation approval process, staff added subdivision (b)(3) to explain the purpose of a waiver of limitation and when auditors should request the taxpayer sign a waiver. The subdivision includes staff’s current policy requiring that supervisory approval of the circumstances which necessitated the request for the waiver is documented in the audit before the waiver is presented to the taxpayer for signature. In further response to interested party concerns, staff added a new policy requiring approval by the District Principal Auditor be documented in the audit before the waiver is presented to the taxpayer for signature, if the extension of the statute of limitations totals two years or more.

Third party information. Interested parties commented that they want to ensure that auditors do not apply the proposed regulation to third parties who may hold information relevant to the audit of another taxpayer, but who are not themselves under audit or examination.

Staff’s proposed regulation explains general audit procedures when a taxpayer is under audit. However, staff does not believe the regulation should be revised to exclude third parties who may hold information relevant to a taxpayer under audit. Government Code section 15618 gives the Board the authority to examine books, accounts, and papers of all persons required to report to it, or having knowledge of the affairs of those required to report. Board staff routinely requests information from third parties for collection or audit purposes.

VI. Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given our limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board staff.

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A. Description of Alternative 1

Exhibit 5 includes a flowchart and timeline showing the general audit process. Proposed Regulation 1698.5 includes:

- The requirement that a detailed audit plan is prepared for all audits; audit staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe;
- An IDR process when the taxpayer does not provide records in response to an auditor's verbal requests for information;
- An AFPS process to inform taxpayers of proposed adjustments when an area of audit work is completed; and
- That in general, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit for prior periods or until an appeal of a prior audit completes the appeal process.

B. Pros of Alternative 1

- By formalizing audit procedures in a regulation - rather than revising the Board's Audit Manual - the procedures are clearly intended to guide Board staff and taxpayers. Providing consistent definitions and procedures allows people with various levels of expertise to navigate through complex audit processes.
- Regulations are more accessible to the public than the Board's Audit Manual.
- Communication between Board staff and the taxpayer is improved through the audit plan, status conferences, and AFPSs.
- Improvements to the audit process may lead to the timelier resolution of audits, potentially reducing audit interest accruals.

C. Cons of Alternative 1

Interested parties believe the regulation's imprecise language will lead to inconsistency in how taxpayers are treated and disputes over how to interpret terms. Furthermore, as a possible outcome of these disputes, a perceived failure of Board staff to follow the regulation could result in litigation to resolve the disputed interpretation and to compel the Board to follow the regulation.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require adoption of a new regulation.

E. Operational Impact of Alternative 1

Staff will notify taxpayers of the new regulation through an article in the Tax Information Bulletin (TIB) as well as offer taxpayer outreach seminars. Staff also intends to prepare guidelines of best audit practices and provide training to all field audit staff and supervisors. The procedures will also be incorporated into the Board's Audit Manual, publications, and training materials.

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F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation, the TIB, and the best audit practice guidelines is considered routine. Any corresponding cost would be absorbed within the Board's existing budget.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff believes the overall impact on taxpayers will be minimal as many of the procedures are already in the Board's Audit Manual. New procedures are designed to improve communication with the taxpayer and improve audit efficiency. Resolving audits more quickly may result in saving taxpayers interest on audit assessments.

As explained in the Discussion section, interested parties believe several of the procedures will be difficult for taxpayers to comply with, and are a step backward from current policy.

H. Critical Time Frames of Alternative 1

Implementation will begin 30 days following approval of the regulation by the State Office of Administrative Law.

VII. Other Alternatives

A. Description of Alternative 2

Do not approve proposed Regulation 1698.5.

B. Pros of Alternative 2

Most of the procedures in the proposed regulation could be added to the Board's Audit Manual. Consequently, the regulation could be viewed as unnecessary. Not promulgating the regulation would avoid interested parties concerns regarding the regulation. The Board would also avoid the workload involved with processing and publicizing the regulation.

C. Cons of Alternative 2

Staff believes incorporating procedures into a regulation will result in a higher level of understanding and compliance than if the procedures were included in the Board's Audit Manual.

D. Statutory or Regulatory Change for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

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F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None.

G. Taxpayer/Customer Impact of Alternative 2

None.

H. Critical Time Frames of Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: November 2, 2009

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Proposed regulation for audit procedures in general

Alternative 1 – Staff Recommendation

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given their limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board of Equalization staff.

Alternative 2 – Other Alternative Considered

Do not approve proposed Regulation 1698.5.

Background, Methodology, and Assumptions**Alternative 1 – Staff Recommendation**

Staff believes that incorporating general audit procedures into a regulation will help staff meet the responsibility for developing the most efficient audit process given their limited resources. The staff recommendation contends that the new regulation formalizes audit expectations and documents the audit process for taxpayers and Board staff.

There is nothing in the staff recommendation that should necessarily impact sales and use tax revenue. However, to the extent that a regulation would be more authoritative than an Audit Manual in ensuring more timely completion of audits and refund claims, there could be an uncertain impact on sales and use tax revenue. That is, incorporating procedures into a regulation may lead to records being provided sooner, allowing for an earlier resolution of an audit. If the documents or information requested indicated that a taxpayer over paid his or her tax obligation, the resulting refund would be accelerated; the taxpayer would benefit from the discovery and the Board may pay less in credit interest. Conversely, if the Board discovered that the taxpayer failed to pay its sales and use tax obligations, the resulting earlier determination could mean acceleration in collections; the taxpayer would have a potential savings in debit interest.

Revenue Estimate

Alternative 2 – Other Alternative – do not revise Regulation 1698.5

There is nothing in the alternative 2 that would impact sales and use tax revenue.

Revenue Summary

Alternative 1 – staff recommendation should not necessarily impact revenue; nonetheless, to the extent that a regulation would be more authoritative than an Audit Manual in ensuring timely resolution of audits and refund claims, there could be an uncertain impact on sales and use tax revenue.

Alternative 2 – alternative 2 does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Robert Ingenito, Chief, Research and Statistics Section, Legislative and Research Division and Mr. Jeff McGuire, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at 916-445-0840.

Current as of November 2, 2009.

Regulation 1698.5. AUDIT PROCEDURES

Reference: Sections 7053 and 7054
Records, see Regulation 1698

(a) DEFINITIONS.

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) 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 as provided in Regulation 1698.
- (9) DAY. For the purposes of this regulation, "day" means calendar day.

(b) GENERAL.

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

- (1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.
- (2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(8) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested

by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

(c) AUDITS.

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference. On audits where electronic records are involved, the

Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Claims for Refund. Taxpayers or their representatives should present claims for refund at the beginning of the audit. A claim for refund that is presented near the conclusion of the audit may be addressed separately so as not to delay the timely completion of the current audit.

(8) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(9) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(10) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(11) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(12) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

District Office Address
District Office Address
xxx-xxx-xxxx • FAX xxx-xxx-xxxx
www.boe.ca.gov

TO:

Taxpayer:
Case ID Number:
Account Number:
Audit Period:

Date:

FROM:

Auditor:
Office Making Audit:

Telephone:
Fax:

Request No. _____
Due Date to Respond: _____

Requested Information/Documents:

(Example: Chart of accounts, general ledger, sales journal, and accounts payable journal for the audit period noted above.)

History Section

Verbal Request:

Verbal request for this information was made on [date] with due date of [date].

Partial Response (if applicable):

(Example: Chart of accounts and general ledger were provided on [date].)

Taxpayer:
Account Number:
Case ID: -2-

First Written Request

Initial IDR# [number] issued on [date] with due date of [date]

Second Written Request

Second IDR# [number] issued on [date] with due date of [date]

Formal Notice and Demand

A formal demand was issued on [date] with a due date of [date].

History of IDRs

Date

xx/xx/xx
xx/xx/xx
xx/xx/xx

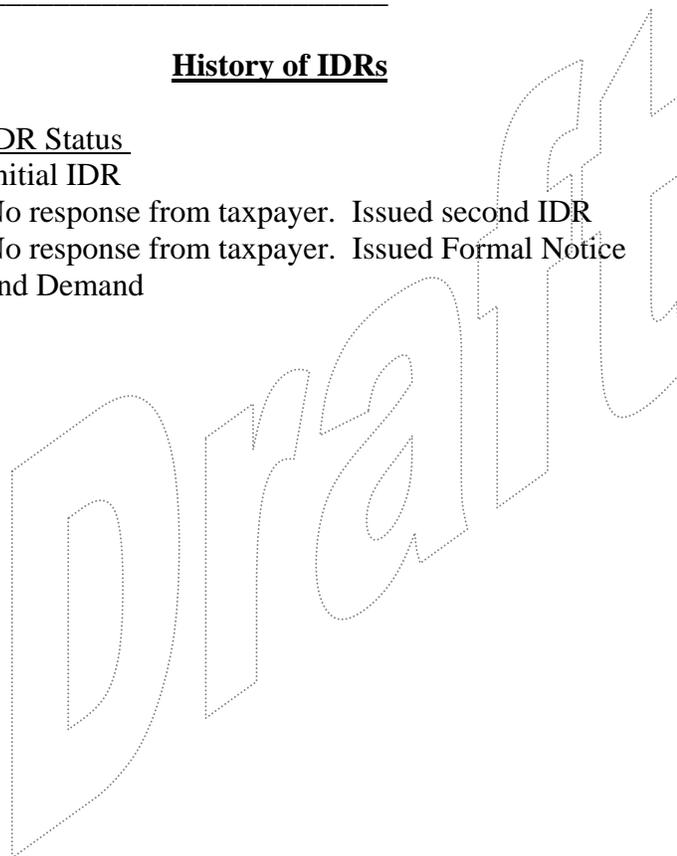
IDR Status

Initial IDR
No response from taxpayer. Issued second IDR
No response from taxpayer. Issued Formal Notice
and Demand

Due Date

xx/xx/xx
xx/xx/xx

xx/xx/xx





STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

District Office Address
District Office Address
xxx-xxx-xxxx • FAX xxx-xxx-xxxx
www.boe.ca.gov

AUDIT FINDINGS PRESENTATION SHEET (AFPS)

AFPS #: _____ **AUDIT FINDINGS FOR:** (Example: Disallowed Claimed Sales for Resale)

Date:

Due Date to Respond:

Auditor:

Auditor Telephone #:

Taxpayer:

Account Number:

Case ID Number:

Audit Period:

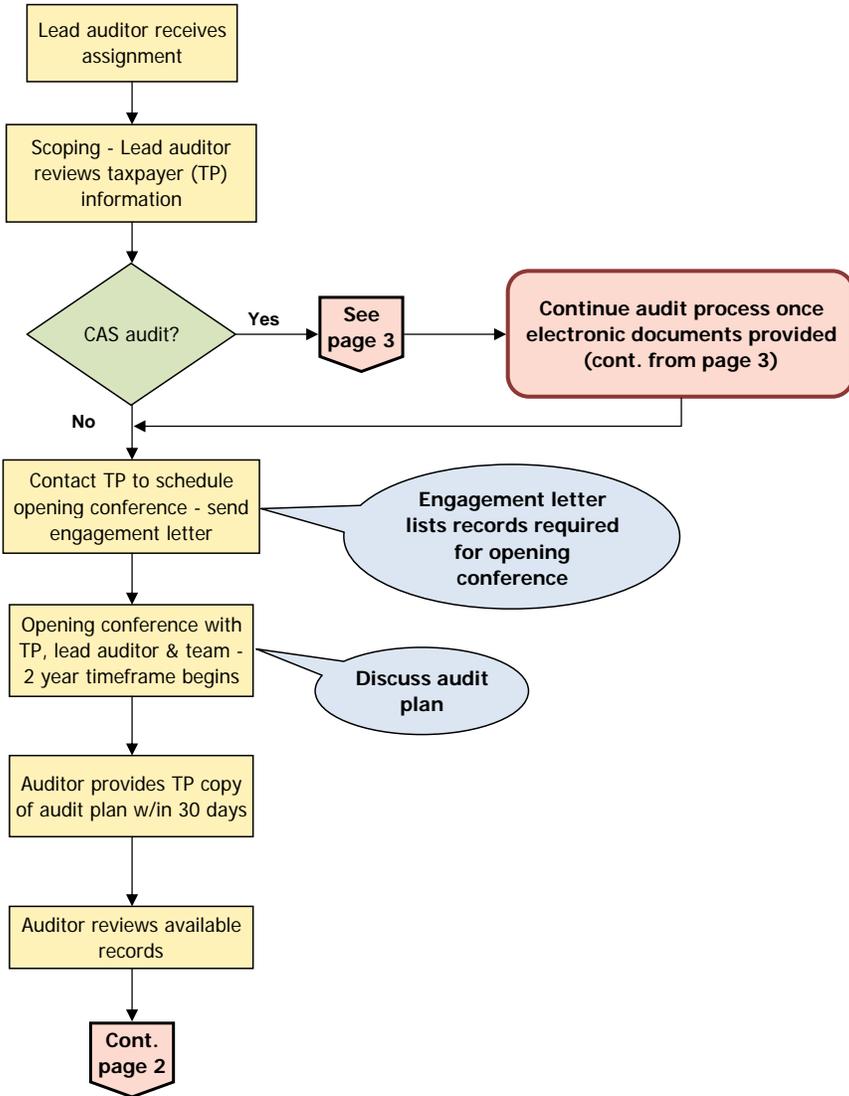
DESCRIPTION OF FINDINGS	SCHEDULE REFERENCE	ESTIMATED TAXABLE MEASURE	TAXPAYER AGREES Y/N

The audit findings presented are the auditor's proposed recommendation for determination and are subject to further review. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

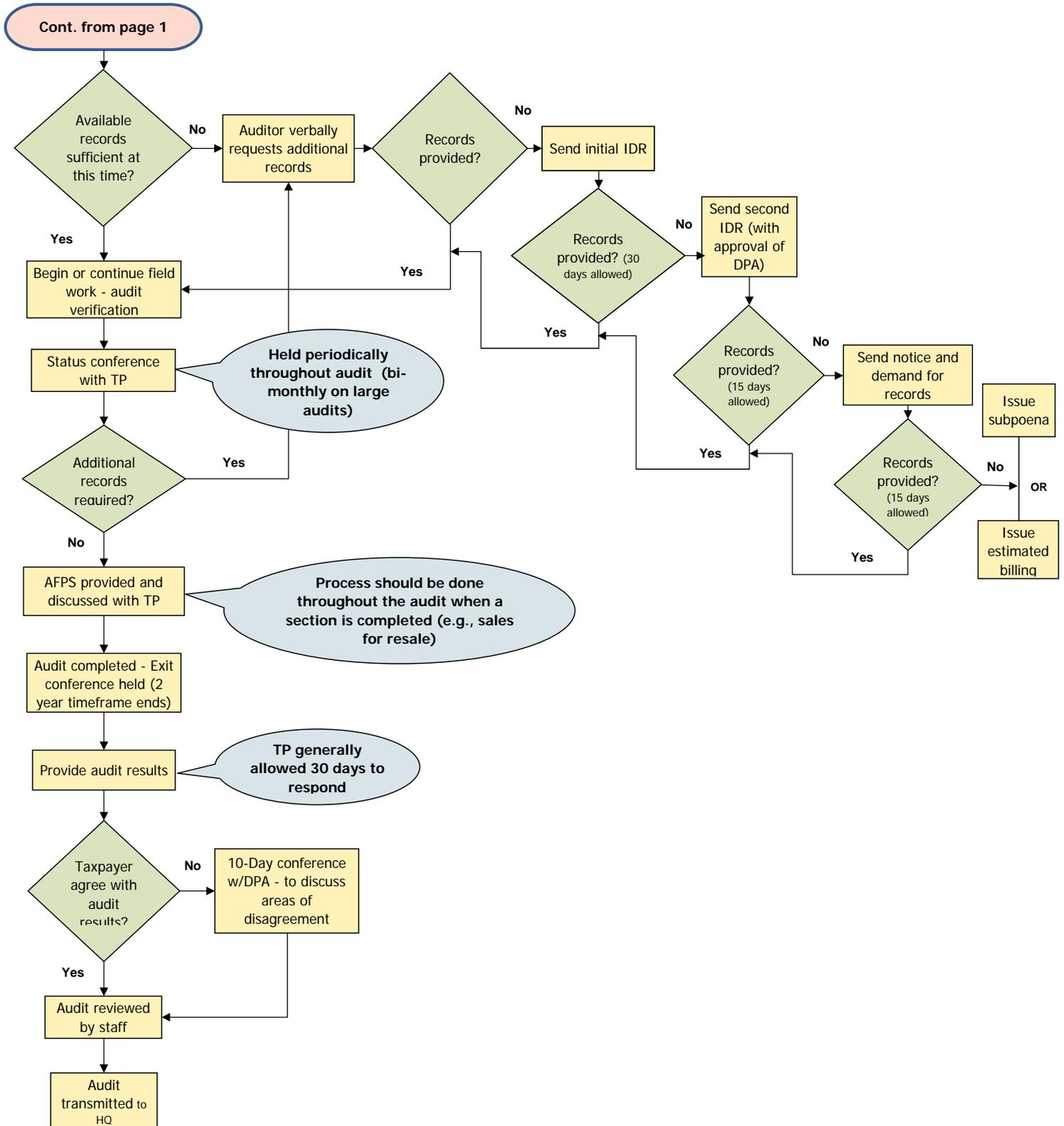
Taxpayers may use audit pre-payment form BOE-1 if at any time during the audit they wish to pay all or part of the proposed audit liability. Advance payment of the tax portion will stop the accrual of interest; however, it will not affect your right to appeal portions of the audit with which you do not agree.

SUMMARY OF FINDINGS:

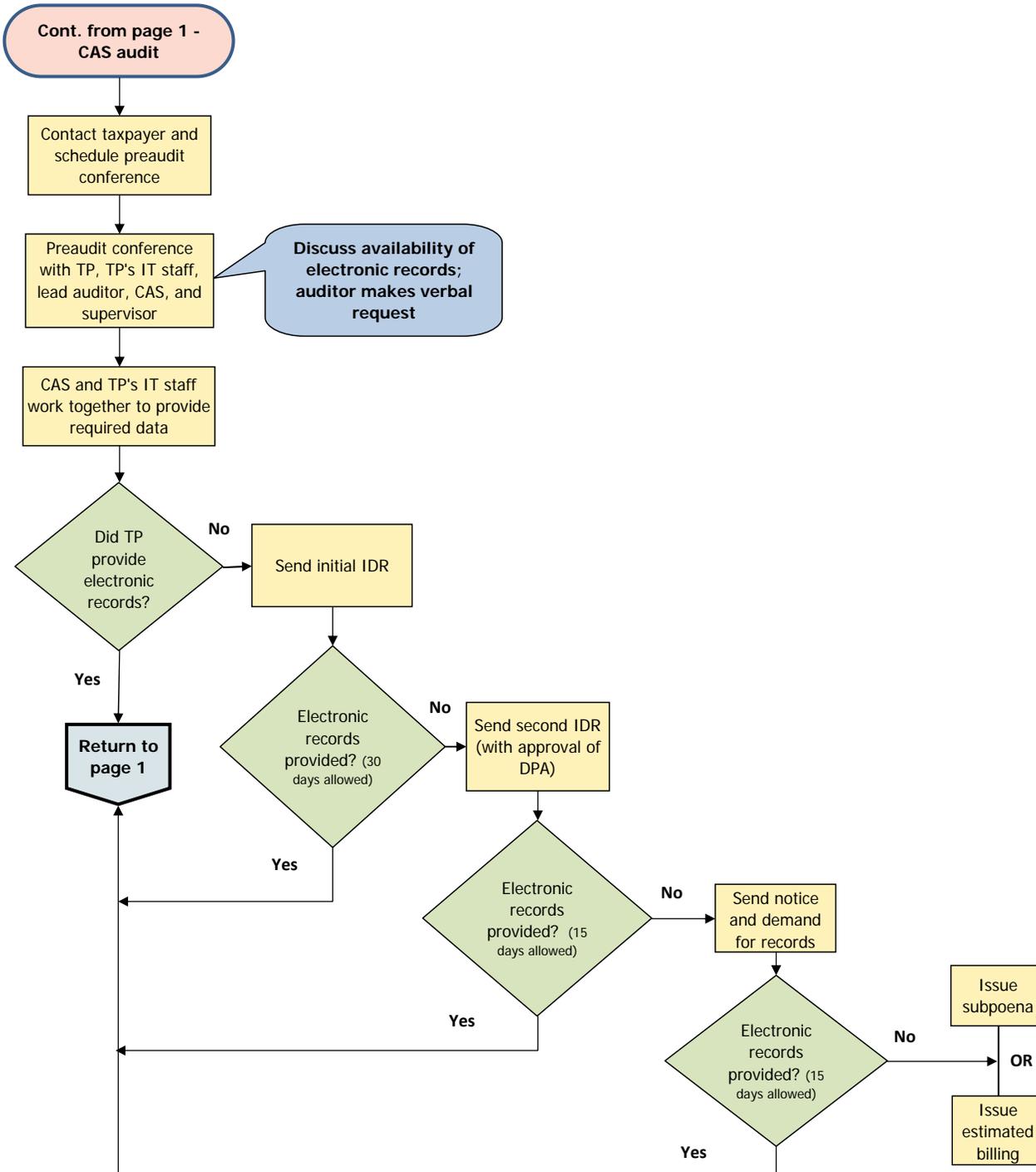
AUDIT PROCESS



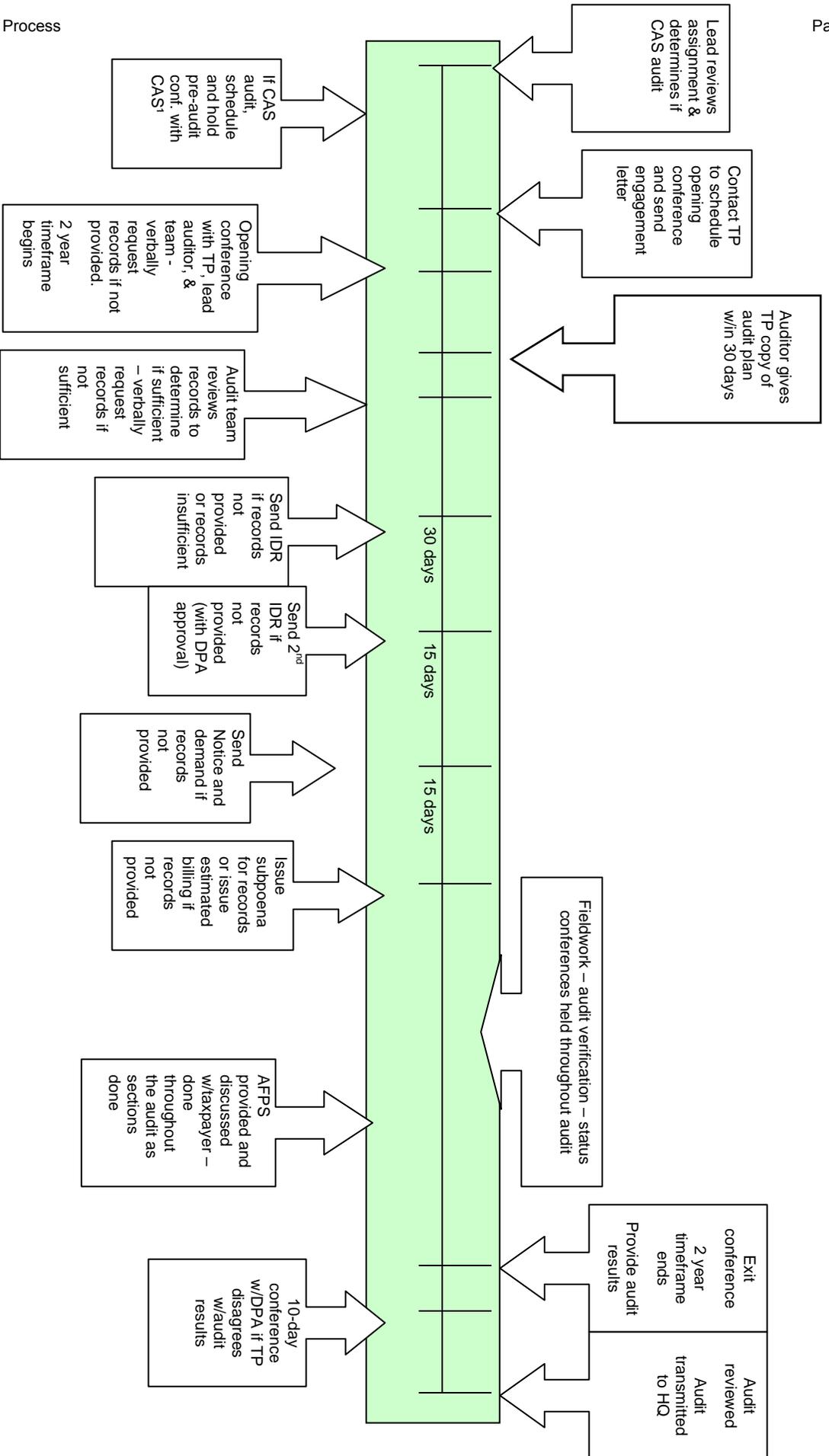
AUDIT PROCESS



AUDIT - Computer Audit Specialist (CAS) PROCESS



Audit Process



¹Refer to page 3 of the flowchart for CAS process