

## Memorandum

To: Honorable Betty T. Yee, Chairwoman  
Honorable Jerome E. Horton, Vice Chair  
Ms. Barbara Alby, Acting Board Member  
Honorable Michelle Steel  
Honorable John Chiang

Date: March 10, 2010

From: Kristine Cazadd  
Chief Counsel 

Subject: **Board Meeting – March 23-25, 2010**  
**Item F – Public Hearing**  
**Staff Recommendation for Additional Changes to the Original Text of Proposed Regulation 1698.5, Audit Procedures, Pursuant to Government Code section 11346.8.**

On November 17, 2009, the Board authorized staff to begin the formal rulemaking process to adopt Sales and Use Tax Regulation (Regulation) 1698.5, *Audit Procedures*, as set forth in exhibit 2 to Formal Issue Paper 09-005. Therefore, Board staff prepared and issued a Notice of Action, made the Initial Statement of Reasons and the original proposed text of the regulation available to the public, and scheduled a public hearing for the March 23, 2010, Board meeting.<sup>1</sup> However, since the November 17, 2009, Board meeting, Sales and Use Tax Department staff and Legal Department staff have identified the need for one grammatical change and four sufficiently related changes to the original text of the proposed regulation, each of which is described in detail below and two of which were suggested by the Taxpayers' Rights Advocate (TRA). Therefore, at the public hearing scheduled during the March 23, 2010, Board meeting, the Legal Department will request that the Board authorize staff to make the additional changes to the original text of the proposed regulation and refer the revised regulation to the 15-day file for additional notice and public comment, as provided for by Government Code section 11346.8, subdivision (c).

### **Changes to Regulation 1698.5, Subdivision(a)(6) and (7)**

Revenue and Taxation Code (RTC) section 7051 authorizes the Board to “prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of” the Sales and Use Tax Law (RTC § 6001 et seq.). The Board’s rulemaking authority includes the authority to prescribe the content and use of forms by regulation so that the form requirements have the force and effect of law.

When the Board determines that it is necessary to prescribe the content of a form by regulation, the Board may include the full text of the form in the text of a regulation duly adopted or amended under chapter 3.5 (commencing with Gov. Code, § 11340) of the Administrative

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<sup>1</sup> For ease of reference, Formal Issue Paper 09-005, and the Notice of Rulemaking, Initial Statement of Reasons, and original proposed text of Regulation 1698.5 are available on the Board’s Website at:  
<http://www.boe.ca.gov/regs/reg1698.5.htm>.

Procedure Act. For example, appendices A and B to Regulation 1668, *Sales for Resale*, include the full text of two Board adopted resale certificate forms. Alternatively, the Board may incorporate the full text of the form into the text of a duly adopted or amended regulation by reference under the procedures prescribed by the Office of Administrative Law (OAL) in Rule 20 (Cal. Code Regs., tit. 1, § 20). For example, Regulation 5603, subdivision (a), provides that a taxpayer's claim for reimbursement "must be filed with the Chief of Board Proceedings on the Taxpayers' Bill of Rights Reimbursement Claim form (7/98), which is hereby incorporated by reference."

In general, Rule 20, subdivision (c), allows the Board to incorporate a form into the text of a regulation by reference if the text of the proposed regulation or amendment states that the form is "incorporated by reference" and identifies the form by title and date of publication or issuance (as illustrated by Regulation 5603). And, the Board's notice of action for the proposed adoption of the regulation or amendment clearly identifies the form to be incorporated by reference by its title and date of publication or issuance; the Board makes the form available to the public during the notice and comment period specified in **the** notice of action; and the Board's final statement of reasons for the proposed adoption of the regulation or amendment demonstrates why it would be cumbersome, unduly expensive, or otherwise impractical to publish the form in the California Code of Regulations.

Formal Issue Paper 09-005 requested the Board's authorization to begin the formal rulemaking process to adopt proposed Regulation 1698.5, as forth in exhibit 2 to the issue paper. As relevant here:

- Pages 4 and 5 of the issue paper described the "Information/Document Request (IDR) process" and the "Audit Findings Presentation Sheet (AFPS) process" provided for in the text of proposed Regulation 1698.5;
- The text of proposed Regulation 1698.5, subdivision (a)(6) and (7), set forth in exhibit 2 to the issue paper, provided that an "Information/Document Request (IDR)" is a "Board form used to request single or multiple documents, data, and other information from the taxpayer under audit"; and an "Audit Findings Presentation Sheet (AFPS)" is a "Board form used to present the staff's findings for each area of the audit as it is completed," respectively;
- The text of proposed Regulation 1698.5, subdivision (c)(10)(B) and (11), set forth in exhibit 2 to the issue paper, prescribed the "Information/Document Request (IDR) process" and the "Audit Findings Presentation Sheet (AFPS) process," respectively;
- And, exhibits 3 and 4 to the issue paper contained draft templates for audit correspondence requesting information and documents and audit correspondence transmitting the Board's audit findings to taxpayers, which the headers referred to as a "Draft IDR Form" and "Draft AFPS Form," respectively.

Formal Issue Paper 09-005 did not request that the Board adopt or authorize staff to issue the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 because the templates were still under development.<sup>2</sup> Furthermore, the issue paper did not request or

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<sup>2</sup> The Sales and Use Tax Department plans to finish development and finalize the templates before it issues the operations memorandum implementing Regulation 1698.5.

recommend that the Board include the full text of the draft templates in the text of proposed Regulation 1698.5 or incorporate the draft templates into Regulation 1698.5 by reference in accordance with Rule 20. This is because the templates do not impose any regulatory requirements on taxpayers or Board staff that are not already provided for in the text of Regulation 1698.5, subdivision (c)(10)(B) and (11), and it is not necessary to prescribe the specific content of the draft templates by regulation. However, OAL staff performed a preliminary review of the original text of proposed Regulation 1698.5 and tentatively concluded that the Board is trying to incorporate the draft templates contained in exhibits 3 and 4 to the issue paper into Regulation 1698.5, subdivision (a)(6) and (7), by reference because the subdivision's text refers to IDRs and AFPSs as Board forms. Therefore, OAL staff contacted Board staff to express concerns that Board staff was not complying with the requirements of Rule 20 because the references to the forms did not include the dates the forms were adopted or issued and Board staff ~~was~~ not making the templates available to the public as part of the rulemaking documents for the proposed adoption of Regulation 1698.5.

The Board's Legal Department and Board Proceedings Division responded to OAL staff's concerns and explained that the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 have not been adopted or issued, the Board is not currently trying to incorporate the templates into Regulation 1698.5 by reference, and the Board does not need to comply with Rule 20. In addition, the Board's Legal Department discussed this matter with OAL's Legal Department and continues to believe that the templates the Sales and Use Tax Department will eventually implement for use in the IDR and AFPS processes will not need to be adopted as regulations because they will not impose any regulatory requirements on taxpayers or Board staff. However, to avoid any confusion and further clarify that the Board is not trying to incorporate IDR and AFPS forms into Regulation 1698.5 by reference in accordance with Rule 20, the Legal Department requests authorization to:

- Change the original text of proposed Regulation 1698.5, subdivision (a)(6), to provide that "Board staff may issue an Information Document/Request (IDR) to request single or multiple documents, data, and other information from the taxpayer under audit," as shown in Attachment A to this memorandum, rather than refer to an IDR as a Board form; and
- Change the original text of proposed Regulation 1698.5, subdivision (a)(7), to provide that "An Audit Findings Presentation Sheet (AFPS) is used to present the staffs findings for each area of the audit as it is completed," as shown in Attachment A, rather than refer to an AFPS as a Board form.

### **Responses to TRA's Comments and Changes to Subdivision (b)(5)(B) and (C)**

On February 5,2010, the TRA Office submitted written comments (see Attachment B) suggesting that the Board delete the phrase "and provide adequate resources to do so" and the word "federal" from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B) and (C), respectively. The Sales and Use Tax Department and the Legal Department agree that the phrase "and provide adequate resources to do so" should be deleted from subdivision (b)(5)(B), as shown in Attachment A, and jointly request the Board's authorization to make the change. In addition, the Sales and Use Tax Department and the Legal Department agree that subdivision (b)(5)(C) should be revised to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by law from requiring that taxpayers do so, as

shown in Attachment **A**, and jointly request the Board's authorization to change subdivision (b)(5)(C) accordingly.

The TRA Office also suggested that the Board:

- A. Delete language from the second sentence in subdivision (a)(6) of the original text of proposed Regulation 1698.5, regarding audit engagement letters;
- B. Add a new subdivision (a)(2) to define the term "Engagement Letter" for purposes of the entire regulation and renumber the other paragraphs in subdivision (a) accordingly; and
- C. Add a new subdivision (c)(1) and renumber the other paragraphs in subdivision (c) accordingly to require "Audit Engagement Letters" to "enclose copies of, or provide references to the website locations of, Board publications explaining the audit process, taxpayers' rights, and appeal rights and procedures," and provide contact information for the auditor and the auditor's supervisor.

The Sales and Use Tax Department does not agree that it is necessary to further define the term "Audit Engagement Letter" for purposes of the regulation, because the term is only used in the original text of proposed Regulation 1698.5, subdivision (a)(6), currently, and there is no forfeiture of rights if the taxpayer fails to respond to this letter. Furthermore, the Sales and Use Tax Department does not agree with the TRA that it is necessary to add a new subdivision (c)(1) because the original text of subdivisions (b)(4)(K) and (c)(6) already requires auditors to "Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit" and requires auditors to provide each taxpayer with the name and telephone number of their audit supervisor, and any Board staff assigned to the audit team, at the taxpayer's opening conference. Therefore, the Sales and Use Tax Department is not requesting the Board's authorization to delete language from the original text of subdivision (a)(6), or add new subdivisions (a)(2) or (c)(1) to the original text of proposed Regulation 1698.5.

Finally, the TRA Office also suggested that the Board:

1. Add language to the original text of proposed Regulation 1698.5, subdivision (b)(4)(J), prohibiting auditors from removing records from taxpayers' premises without permission and requiring auditors to provide signed receipts for any records they do remove from a taxpayer's premises; and
2. Revise the original text of proposed Regulation 1698.5, subdivision (b)(4)(K), to change taxpayer's to taxpayers', and require auditors to "be prepared to respond to questions about the audit process, taxpayers' rights, and appeal rights at any time during the course of [an] audit."

The Sales and Use Tax Department does not agree that the suggested changes to the original text of proposed Regulation 1698.5, subdivision (b)(4)(J) and (K), are necessary. This is because the original text of proposed Regulation 1698.5, subdivision (b)(4)(J), already requires auditors to "Safeguard taxpayers' records while examining them"; section 0403.35, *Receipt for Taxpayer's Records*, of the Board's Audit Manual' already requires auditors to safeguard

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<sup>3</sup> For ease of reference, chapter 4, *General Audit Procedures*, of the Audit Manual is available at <http://www.boe.ca.gov/pdf/fam-04.pdf>.

taxpayer information and provide receipts for records that are removed from taxpayers' premises; and the original proposed text of Regulation 1698.5, subdivision (b)(4)(K), already requires auditors to "Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit." Therefore, the Sales and Use Tax Department and the Legal Department are not requesting the Board's authorization to add language to subdivision (b)(4)(J) or revise subdivision (b)(4)(K) of the original text of proposed Regulation 1698.5.

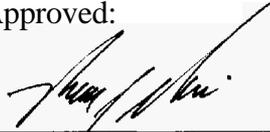
**Solely Grammatical Changes**

Finally, the Sales and Use Tax Department and Legal Department request the Board's authorization to delete the word "the" before the reference to "AFPSs" in the original text of proposed Regulation 1698.5, subdivision (a)(7), as shown in Attachment A, to make the revised sentence grammatically correct.

**Conclusion**

The Sales and Use Tax Department and the Legal Department request that the Board authorize staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5, as shown in Attachment A, and refer the changes to the regulation to the 15-day file for additional public comment in accordance with Government Code section 11346.8, subdivision (c). Both departments believe that the recommended changes are necessary to clarify that the Board is not trying to incorporate regulatory forms into the proposed regulation, ensure that the proposed regulation does not require taxpayers to devote more resources to their audits than currently required, prohibit auditors from requiring taxpayers to produce documents when prohibited by law, not just federal law, and correct a minor grammatical error.

If you need more information or have any questions, please contact Tax Counsel III (Specialist) Bradley Heller at (916) 324-2657.

Approved:  
  
Ramon J. Hirsig  
Executive Director

Attachments: Suggested Changes to Proposed Text of California Code of Regulations, Title 18  
Taxpayers' Rights Advocate Office Comments on Proposed Regulation 1698.5,  
Audit Procedures

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|-----|------------------|---------|--------------------|---------|
| cc: | Mr. Ramon Hirsig | MIC: 73 | Ms. Leila Hellmuth | MIC: 50 |
|     | Ms. Randie Henry | MIC: 43 | Mr. Randy Ferris   | MIC: 82 |
|     | Mr. Jeff McGuire | MTC: 92 | Mr. Bradley Heller | MIC: 82 |

Suggested Changes to Proposed Text of  
California Code of Regulations, title 18

**Regulation 1698.5. Audit Procedures.**

**(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 staff may issue an Information Document/Request (IDR) 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). An Audit Findings Presentation Sheet (AFPS) is ~~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 staffs 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)(7) 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)(7) of this regulation, and provide the resources to do so.

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The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(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; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) 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 the Board is ~~otherwise~~ prohibited by ~~federal~~ law from requiring the specific documents.

(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.

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### **(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 and the audit for the subsequent periods is not held in abeyance, 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, whether or not the taxpayer has authorized another party to represent them. 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.

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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) 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.

(8) 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.

(9) 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

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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.

(10) 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.

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The **proposed** language contained in this document may not be adopted. Any **revisions** that are adopted may differ from this **text**.

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.

(11) 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.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.

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**Memorandum**

To : Mr. Rick Bennion, Acting Regulations Coordinator  
Board Proceedings Division, **MIC:81**

Date : February 5, 2010

From : Todd C. Gilman, Chief   
Taxpayers' Rights and Equal Employment Opportunity Division, MIC: 70

Subject : **Comments on Proposed Regulation 1698.5, Audit Procedures**

The Taxpayers' Rights Advocate Office wishes to recommend revisions to proposed Sales and Use **Tax** Regulation 1698.5, **Audit Procedures**, in connection with the public hearing on **the** proposed adoption of Regulation 1698.5, scheduled for March **23**, 2010. The revisions described below and shown in strikeout and underline text are needed to ensure the adequate protection of taxpayers' rights. I have included commentary about some of the revisions in brackets and italics.

**(a) DEFINITIONS**

(2) ENGAGEMENT LETTER. Correspondence used by the auditor to confirm the start of an audit or establish contact with the taxpayer.

*[New subdivision (a)(2) is to be placed prior to current subdivision (a)(2), and the remainder of the subdivisions in (a) are to be re-numbered.]*

(67) 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.

*[A separate definition for Audit Engagement Letter should be included in the list of terms, rather than included within the definition of another term.]*

**(b) GENERAL**

**(b)(4) Duty of Board Staff.**

(J) Safeguard taxpayers' records while examining them. Do not remove records from taxpayer's or taxpayer's representative's premises without permission from the taxpayer or designee. Provide signed receipt for any records removed from the premises.

*[It is important to be more specific on how Board staff effectively safeguards the taxpayer's records.]*

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit and be prepared to respond to questions about the audit process, taxpayers' rights, and appeal rights at any time during the course of the audit.

*[All Board staff are expected to be knowledgeable about taxpayers' rights and audit staff have the responsibility of safeguarding and respecting those rights.]*

**(b)(5) Duty of Taxpayers.**

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the **original audit plan**, or in the **audit plan** as amended pursuant to subdivision (c)(7) of this regulation; ~~and provide adequate resources to do so.~~

*[It ~~is~~ presumptuous and exceeds **BOE** authority to promulgate requirements regarding allocation of the taxpayer's resources.]*

(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.

*[There also may be state laws or regulations that prohibit the copying of specific documents.]*

**(c) AUDITS.**

(1) Audit Engagement Letter. The audit engagement letter will enclose copies of or provide references to the website locations of Board publications explaining the audit process, taxpayers' rights, and annual rights and procedures. The audit engagement letter will also provide contact information for the auditor and the auditor's supervisor.

*[New subdivision (c)(1) is to be placed prior to current subdivision (c)(1), and the remainder of the subdivisions in (c) re-numbered.*

*I understand the current procedure is to provide copies – or provide references to the location on the website – of the following BOE publications with the Audit Engagement Letter:*

- Publication 17, Appeals Procedures
- Publication 70, Understanding Your Rights as a California Taxpayer
- Publication 76, Audits

***Regulation 1698.5** should enunciate the auditor's **duty** to provide the taxpayer with written materials describing his or her rights.]*

Please let me know if you have any questions regarding these suggestions.

TCG:ls

Bennion memo 020510 (1698-5 comments).doc

cc: Ms. Randie Henry, Deputy Director, Sales and Use **Tax** Department, MIC: 43



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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JEROME E. HORTON  
Fourth District, Los Angeles

JOHN CHIANG  
State Controller

RAMON J. HIRSIG  
Executive Director

January 20, 2010

To Interested Parties:

**NOTICE OF CORRECTION**  
**By the**  
**The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,**  
**Title 18, Section 1698.5, *Audit Procedures***

The State Board of Equalization issued an Interested Parties Letter on January 15, 2010 concerning California Code of Regulations, title 18, section (Regulation) 1698.5, Audit Procedures. The second paragraph of the letter contained a typographical error, which incorrectly indicated that the public hearing regarding the proposed regulatory action was scheduled for March 23, 2009, and that the deadline for the Board to receive written comments was prior to the start of the 2009 hearing. The NOPRA should have correctly provided that:

“A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or **as** soon thereafter as the matter may be heard, on March 23, 2010. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation.”

“Any interested person may also submit written comments regarding the adoption of the proposed regulation. The written comment period closes at 9:30 a.m., or as soon thereafter **as** the matter may be heard, on March 23, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation.”

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by

Notice of Proposed Regulatory Action  
Regulation 1698.5

January 20, 2010

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:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,

A handwritten signature in black ink that reads "Diane G. Olson". The signature is written in a cursive style and is placed on a light gray rectangular background.

Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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**January 15, 2010**

**To Interested Parties:**

**Notice of Proposed Regulatory Action  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

**NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2009. At the hearing, any interested person may present or submit oral or written Statements, arguments, or contentions regarding the adoption of the proposed regulation. In addition, if the Board receives written comments prior to the hearing on March 23, 2009, the statements, arguments, and/or contentions contained in those comments will be presented to and considered by the Board before the Board decides whether to adopt the proposed regulation.

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

### **Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

### **Proposed Regulation**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staffs and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit

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<sup>1</sup> The Board's Audit Manual is available at [www.boe.ca.gov/sutax/staxmanuals.htm](http://www.boe.ca.gov/sutax/staxmanuals.htm).

a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- *A pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- *An opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- *A status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- *An exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.

There are no comparable federal regulations or statutes to proposed Regulation 1698.5.

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

The Board has determined that proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts that are 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 proposed Regulation 1698.5 will result in no direct or indirect cost or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

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

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Therefore, the Board has made an initial determination that proposed Regulation 1698.5 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 proposed regulation may affect small business.

### **NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

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

### **RESULTS OF THE ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the adoption of proposed Regulation 1698.5 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.

## **NO SIGNIFICANT EFFECT ON HOUSING COSTS**

Adoption of proposed Regulation 1698.5 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 this action is proposed, or be as effective as and less burdensome to affected private persons than the proposed action.

## **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov) or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting 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:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## **AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 1698.5 showing its express terms. These documents and all 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 regulation 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 proposed Regulation 1698.5 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

January 15, 2010

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 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 proposed Regulation 1698.5, 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,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures

## Initial Statement of Reasons

### Proposed Adoption of California Code of Regulations, Title 18, Section 1698.5, *Audit Procedures*

#### SPECIFIC PURPOSE AND NECESSITY

Revenue and Taxation Code section (section) 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require. Section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits. Therefore, the Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation.

Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day." Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staffs and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request.

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<sup>1</sup> The Board's Audit Manual is available at [www.hoe.ca.gov/sutax/staxmanuals.htm](http://www.hoe.ca.gov/sutax/staxmanuals.htm).

Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

Proposed regulation 1698.5 is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.

## **DOCUMENTS RELIED UPON**

The Board relied upon Formal Issue Paper 09-005 (November 2, 2009) and comments from interested parties and Board staff made during the Board's November 17, 2009, Business Taxes Committee meeting in deciding to propose the adoption of Regulation 1698.5. Issue Paper 09-005 is available on the Board's Website at [www.boe.ca.gov/meetings/pdf/Combined\\_1698.5.pdf](http://www.boe.ca.gov/meetings/pdf/Combined_1698.5.pdf). The audio and video from the November 17, 2009, Business Taxes Committee meeting is available on the Board's Website at [www.visualwebcaster.com/event.asp?id=53985](http://www.visualwebcaster.com/event.asp?id=53985). The minutes from the November 17, 2009, Business Taxes Committee meeting are available on the Board's Website at [www.boe.ca.gov/meetings/pdf/111709-Board-committee-minutes.pdf](http://www.boe.ca.gov/meetings/pdf/111709-Board-committee-minutes.pdf).

## **ALTERNATIVES CONSIDERED**

The Board considered whether it would be more appropriate to take no action as an alternative to adopting proposed Regulation 1698.5, during the Board's November 17, 2009, Business Taxes Committee meeting. The Board decided to propose the adoption of Regulation 1698.5 because the regulation is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.

## **NO ADVERSE ECONOMIC IMPACT ON BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Furthermore, proposed Regulation 1698.5, subdivision (c)(4), expressly provides that "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." Therefore, the Board has determined that the proposed regulation will not have a significant adverse economic impact on business.

**Proposed Text of California Code of Regulations,  
Title 18, Section 1698.5**

**1698.5. Audit Procedures.**

**(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)(7) 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)(7) 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)(7) 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 and the audit for the subsequent periods is not held in abeyance, 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, whether or not the taxpayer has authorized another party to represent them. 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) 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.

(8) 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.

(9) 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.

(10) 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.

(11) 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.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.

## Regulation History

**Type of Regulation:** Sales and Use Tax

Regulation: 1698.5

Title: 1698.5, *Audit Procedures*

**Preparation:** Brad Heller

**Legal Contact:** Brad Heller

Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation

### History of Proposed Regulation:

March 23, 2010	Public hearing
March 1, 2010	45-day public comment period ends
January 15, 2010	OAL publication date; 45-day public comment period begins; IP mailing
January 5, 2010	Notice to OAL
November 17, 2009	Business Tax Committee, Board Authorized Publication (vote 5 -0)

Sponsor: NA

support: NA

Oppose: NA