

Memorandum

To : Mr. Ramon J. Hirsig
Executive Director (MIC 73)

Date: August 3, 2004

From : 
Freda Orendt, Acting Deputy Director
Sales and Use Tax Department (MIC 43)

Subject : Proposed revisions to Audit Manual Chapter 1

In accordance with the established procedures for audit and compliance manual revisions, I am submitting the following proposed revisions to Audit Manual Chapter 1, *Introduction*, for your approval to forward to the Board Proceedings Division. These changes have been reviewed and approved by SUTD management, provided to Board Members, and posted on the website for two months at <http://www.boe.ca.gov/sutax/staxmanuals.htm> to solicit comments from interested parties.

No comments were received. On July 22, 2004, we sent a memo advising Board Members that there were no comments and of our intention to place these revisions on the August 24, 2004 Administrative Agenda.

Summary of Revisions

- **AM Section 0101.20.** Revises titles to correspond with the reorganization of the Sales and Use Tax Department.
- **AM Section 0101.65.** Adds 'status of permit' to list of non-confidential information. Also explains the limited situations when confidential information can be released without a written authorization from the taxpayer.
- **AM Section 0101.67.** Explains procedures for tagging audit working papers that include information obtained directly from the IRS.
- **AM Section 0101.75.**
 - Clarifies that relief under section 6596 only applies to the person who wrote the inquiry letter. Customers or vendors that obtain a copy of a letter written to someone else do not qualify for relief.
 - Clarifies that a waived audit does not meet the provisions of section 6596. In addition, form letter BOE-79-F, Audit Transmittal Letter- Courtesy Letter to Taxpayer When Account is Field Waived, does not qualify as written advice under section 6596.
- **AM Section 0101.90.** Explains the procedures for destruction of audit file material including special procedures for audit working papers that include information obtained directly from the IRS.

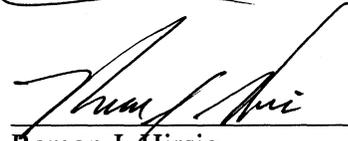
- **AM Section 0101.95.** Provides procedures when identity theft is discovered.

Attached are copies of these proposed revisions.

We request your approval to forward these proposed changes to the Board Proceedings Division for placement on the next Administrative Agenda as a consent item.

If you have any questions, please let me know or contact Mr. Jeff McGuire at 323-8690.

Approved:



Ramon J. Hirsig
Executive Director

Attachment

cc: (all without attachments)
Mr. Stephen Rudd (MIC 47)
Ms. Freda Orendt (MIC 46)
Mr. Jeff McGuire (MIC 92)

BOARD APPROVED
At the Month Day, Year Board Meeting

Deborah Pellegrini, Chief
Board Proceedings Division

bc: Lynn Whitaker (MIC 44)
AIS Files – AM Revisions

Proposed Audit Manual Revisions

TAX AUDIT POLICIES

(CONT.) 0101.20

An auditor's skill is not measured by the additional understatements and overstatements disclosed in his/her audits. Under no circumstances will an auditor's performance be rated upon the basis of recovery, which is prohibited by law. Additionally, aged audits and other audit program-level performance measurements established by Board management to evaluate district offices are not designed nor should they be used for evaluating an individual auditor's performance. This does not mean that an auditor may waste time on assignments by using ineffective audit techniques and performing nonessential tasks and still receive a satisfactory rating. It does mean that if the auditor works diligently, uses the kind of verification methods best fitted to the particular assignment, and performs a professional job with a reasonable expenditure of time, the work performance will be satisfactory.

E. Implementation of Auditing Policy

The ~~Program Planning~~ Tax Policy Manager, Chief of Field Operations, Collections and Third District Operations Manager, and District Administrators have the responsibility to effectively carry out ~~effectively~~ the policy set forth in this statement. They will issue such instructions as it is deemed necessary to implement this policy.

Proposed Audit Manual Revisions

CONFIDENTIAL INFORMATION

0101.65

The ~~Government~~ Civil Code and most of the business tax laws contain provisions making it illegal to divulge to any unauthorized persons information regarding a taxpayer's affairs obtained through audit investigation or from returns or reports. (This includes information contained in Forms BOE-1164 and BOE-1032; see section 0401.20). Information of this nature contained in Board records must be treated in strict confidence. The only exception is when the Governor, by general or special order, authorizes other state officers, tax officers of another state, the Federal Government (if a reciprocal agreement exists), or any other person to examine the records maintained by the Board. Requests for information of a confidential nature should be referred to a supervisor.

Under the Sales and Use Tax program, all but the following information is confidential: account number, business name, names of general partners, business and mailing addresses, business code, ownership designation, start and close-out dates, status of permit (i.e., active/inactive), and tax area code. However, disclosure of the name and address of an individual may be prohibited by Civil Code ~~Section-section~~ 1798.69. (Civil Code ~~Section-section~~ 1798.69 provides in part that the Board may not release the names and addresses of taxpayers except to the extent necessary to verify resale certificates or administer the tax and fee provisions of the Revenue and Taxation Code.) You should be aware that nonconfidential information in other business tax and fee programs differs from that in the Sales and Use Tax program.

Requests by a taxpayer's representative for information and records under the Information Practices Act and the California Public Records Act will be guided by the following policy:

- A taxpayer's representative may examine and/or receive copies of the same information the taxpayer is entitled to, provided the representative presents a written authorization from the taxpayer. This includes copies of all correspondence and, if involved with an audit, petition for redetermination, or claim for refund, a copy of the report findings. It is not necessary that the written authorization be notarized.

Exceptions to the written authorization rule:

~~(Exceptions to the written authorization rule are made in the case of attorneys and certified public accountants who request the information in writing and/or who are known to represent the taxpayer.)~~

1. ~~•~~ Taxpayer directed - Written authorization is not required when supplying copies of audit working papers ~~on an audit~~ to the taxpayer's bookkeeper or accountant when the taxpayer directed the Board to contact his/her bookkeeper or accountant to conduct an audit and the audit was made based on information supplied by the bookkeeper or accountant.
2. Oral inquiries - Attorneys and CPAs may examine and/or receive copies of information without having written authorization if the person is known by the Board to represent the taxpayer. Most oral requests are for an informal review of working papers before the audit is transmitted to Headquarters - generally when the representative has been working with district staff. Staff should screen for situations that may involve speculative inquiries by persons who may be aware of the general subject matter and a taxpayer's business name or account number, but have not been asked by the taxpayer to represent them. Staff should check the taxpayer's file and the appropriate IRIS screens to verify the person has represented the taxpayer in the past. (APL MH and TAR AI have fields for the name of the taxpayer's accountant or representative; audit subsystem screens can be used to access the audit report or prior audit report to view comments indicating who maintained the records and who was involved in the discussion of audit findings.)

Preferably, a stream of correspondence exists for the current audit which clearly establishes the attorney's or CPA's relationship with the taxpayer. If the only information available on IRIS

Proposed Audit Manual Revisions

involves a prior audit, or the representative has recently been added, the file should be carefully reviewed to determine what event created the authorization. If staff is still unsure as to whether the attorney or CPA is in fact a representative of the taxpayer, staff may contact the taxpayer by telephone to confirm the authorization. Alternatively, staff should ask the person to put the request in writing and state specifically that he or she represents the taxpayer in question. Attorneys and CPAs have an ethical responsibility not to misstate their authority to represent their clients.

Requests for copies of district, appeals, and central files must be obtained in writing.

3. Written inquiries - Attorneys and CPAs may examine and/or receive copies of information without having written authorization from the taxpayer if they request the information in writing and clearly indicate that they are authorized to represent the taxpayer. When copy requests are made for file information, the supervisor should review the appropriate IRIS screen printout indicating the representative's name before the request is approved and copies mailed. As explained in (2) above, staff should review IRIS and the taxpayer's file to screen for speculative inquiries. If staff still has doubts, they should contact the taxpayer to confirm authorization.

- ~~Notarization of written authorizations is not a requirement.~~

SAFEGUARDING INFORMATION OBTAINED FROM THE IRS

0101.67

In order to comply with Internal Revenue Service (IRS) information safeguarding requirements, Form BOE-85, Inspection or Disclosure Limitations, must be attached to the audit working papers (AWPs) to flag any page that includes information obtained directly from the IRS. This includes data that is transcribed from an IRS obtained income tax return into the AWPs. For example, a sales reconciliation that includes transcribed amounts from a Schedule C or a schedule of purchases subject to use tax where the assets were found on the income tax return depreciation schedule. It is *not* necessary to attach Form BOE-85 to AWPs that include information from income tax returns obtained from someone other than the IRS, such as the taxpayer or Franchise Tax Board.

As explained in AM 0101.90, AWPs that include information obtained directly from the IRS must be destroyed in the same manner as the actual records obtained from the IRS.

SECTION 6596 GUIDELINES FOR TAXPAYER CORRESPONDENCE**0101.75**

The Board is empowered to relieve taxpayers of tax, interest, ~~or and~~ penalty where the Board finds that the failure to make a timely return or prepayment was due to the taxpayer's reasonable reliance on written advice from the Board. See Regulation 1705 for further information. The following constitutes written advice by the Board:

- **ADVICE PROVIDED IN A WRITTEN COMMUNICATION.** Written advice by the Board to a taxpayer in response to a taxpayer's specific written inquiry or from his or her representative seeking relief from liability will constitute written advice that can be relied on for ~~Section-section~~ 6596. To be considered a specific written inquiry, representatives must identify the specific taxpayer for whom the advice is requested. Such an inquiry must also fully describe the specific facts and circumstances of the activity or transactions for which the advice was requested.

In responding to accountants, attorneys, or other taxpayer representatives where the name of the taxpayer is not divulged, the writer will ask that the representative divulge the name and permit number of the taxpayer to enable the Board to maintain appropriate records with respect to the information provided. The taxpayer's name and permit number will be referenced in the Board's response.

Tax advice to trade associations, taxpayer representatives failing to identify their clients, and/or taxpayers whose questions are vague or general in nature must include the following statement:

The answer given is intended to provide general information regarding the application of the tax and will not serve as a basis for relief of liability under ~~Section-section~~ 6596.

If individual taxpayers are identified, but background information is incomplete, the taxpayer should be encouraged to write again setting forth the specific facts. Staff is encouraged **not** to make presumptions. However, should it become necessary to do so, they should be clearly identified as such in the letter.

Written advice may only be relied upon by the taxpayer to which it was originally issued or a legal or statutory successor to that taxpayer. Written advice that may serve for relief under ~~Section-section~~ 6596 must include the following statement:

The opinion expressed in this letter may only be relied upon for relief under ~~Section-section~~ 6596 of the Sales and Use Tax Law by (state taxpayer's name). If you provide this letter to your customers or vendors, those customers or vendors must write to the Board and obtain their own written opinion in order for them to qualify for relief under section 6596. Any person seeking relief under this section will be required to furnish a copy of ~~the-their own~~ original written inquiry to the Board ~~and along with a copy of this written advice of the~~ written response they received from the Board.

- **WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT.** Presentation of a taxpayer's books and records to an auditor for examination is considered a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence that demonstrates the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board." The facts and conditions in the current situation at hand must be the same as those during the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding of relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

Written advice from the Board that was received during a prior audit of a taxpayer under the above conditions may be relied upon by the taxpayer audited or by a legal or statutory

Proposed Audit Manual Revisions

successor to that person.

However, the cursory review of records performed when an audit is waived does not meet the provisions of section 6596. Unlike a no change audit recommendation, a waiver does not represent acceptance of the taxpayer's returns. Similarly, the BOE-79-F, Audit Transmittal Letter – Courtesy Letter to Taxpayer When Account is Field Waived, informing taxpayers that their account is being waived for audit will not qualify as written advice to relieve the taxpayer from tax, penalty, and interest under section 6596.

A record of the number of letters received and responded to will be maintained by District Administrators and Headquarters' Supervisors. A monthly report along with copies of all letters confirming transactions of an exempt nature, modification/recision letters, and the taxpayer's original inquiry letter will be forwarded to the ~~Public Information and Administration~~ Audit and Information Section for final review of the letters' accuracy. Any correspondence requiring adjustment will be returned to the originating party. Correspondence not providing exemption advice, which would otherwise entitle a taxpayer to relief under ~~Section~~ section 6596, should *not* be forwarded to the ~~Public Information and Administration~~ Audit and Information Section.

When an opinion has been issued, and it is subsequently determined that the tax advice as applied to the facts given was incomplete or incorrect, appropriate modification or recision letters should be sent to the taxpayer. Written advice may also be invalidated by a change in statute or constitutional law, a change in the Sales and Use Tax Regulations, or a final decision of a court, rendering the Board's earlier written advice invalid.

DESTRUCTION OF FILE MATERIAL

0101.90

CPPM section 910.000 provides guidelines for the destruction of district account folder information. As explained in that section, audit staff will be responsible for determining if audit reports and audit working papers (AWPs) should be destroyed.

General Purging Guidelines

For active accounts, all audit reports and AWPs must be retained in the districts' files. Audit reports and AWPs for closed out accounts may be purged provided there is no tax liability owing from the audit, pending litigation, active liens for written-off liabilities, petition for redetermination, claim for refund, pending request for 6596 relief, or other similar matter. When audits of closed out accounts have met these purging guidelines, the audit report and AWP's should be destroyed. In the instance where there is a legal successor to the closed out account, the district should decide on a case-by-case basis whether the AWP's of the predecessor should be retained.

Information from the Internal Revenue Service (IRS)

Any page of AWPs that includes information obtained directly from the IRS (including transcribed information) must be destroyed in the same manner as the actual records obtained from the IRS. AWPs that contain IRS information should be identified with an attached Form BOE-85, Inspection or Disclosure Limitations. When the audit report and AWPs are ready for destruction, these flagged pages must be removed from the AWPs and sent to the Tax Policy Manager for destruction.

IDENTITY THEFT PROCEDURES – ABSOLVING THE INNOCENT PARTY 0101.95

Identity theft occurs when someone appropriates the personal information of others without their knowledge with the intent to commit fraud or theft. It is a felony in California to use the personal identifying information of another person without the authorization of that person for any unlawful purpose (Penal Code section 530.5 et.seq.). Specific guidelines should be followed to absolve the innocent party of tax liabilities that occur as a result of identity theft.

Procedures

In the event an auditor uncovers a situation where an individual has assumed another's identity, the auditor should collect documentary evidence supporting the identity theft from the innocent party. Supporting documentary evidence includes police and/or court reports. The auditor should thoroughly examine the evidence and alert the audit supervisor. The audit supervisor will notify other potentially affected sections (i.e., Centralized Collections, Special Procedures) that may have additional pertinent information. The audit supervisor will also contact the Investigations Division, notifying them a potential identity theft has occurred. Copies of all pertinent documents will be forwarded to the Investigations Division, as they are responsible for contacting law enforcement.

Once the auditor and audit supervisor are satisfied the provided documents support identity theft, the case should be forwarded to a compliance supervisor. The compliance supervisor will review the case and approve a legal adjustment to the taxpayer's (innocent party) account. This legal adjustment will delete the disputed liability from the taxpayer's account. After the adjustment, copies of the file documents should be sent to the Internal Security and Audit Division.