

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.¹ 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 staff's 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.

¹ The Board's Audit Manual is available at www.boe.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. 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. 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.

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.