

Notice of Proposed Regulatory Action

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, 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. In addition, if the Board receives written comments prior to the hearing on March 23, 2010, 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.¹ 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 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. 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.

¹ The Board's Audit Manual is available at www.boe.ca.gov/sutax/staxmanuals.htm.

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, 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, 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.

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 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.