



1 on Use Tax Payable Reports. The Department reconciled reported purchases subject to use tax to the  
2 amounts recorded on the Use Tax Payable Reports and found no material differences. It then tested the  
3 recorded amounts using stratified statistical sampling. The Department divided the population into  
4 four strata, reviewing all purchases of \$300,000 and over on an actual basis. The Department sampled  
5 each of the three strata of purchases less than \$300,000 to compute separate percentages of error,  
6 which it applied to the portion of the population in the relevant strata. Combining the data from all  
7 four strata results in a confidence interval of 24.718 percent at an 80 percent confidence level, which  
8 the Department found to be well within the Board's standard for an acceptable confidence interval of  
9 75 percent. The Department noted further that, at a 90 percent confidence level, the confidence  
10 interval is 31.67 percent, still well within the 75 percent standard.

11 Petitioner does not dispute any of the errors found in the test, but it disputes the sampling  
12 method for several reasons. First, petitioner states that the use of an 80 percent confidence level and a  
13 75 percent confidence interval produces a meaningless result. Petitioner asserts that the confidence  
14 level should be at least 90 percent, and the confidence interval should be no more than 10 percent.  
15 Petitioner also argues that the portion of the test that was done on an actual basis (stratum 4) should be  
16 excluded from the evaluation of the sample, such that the evaluation of the sample is limited to that  
17 portion of the population that was tested. Petitioner has computed that, at an 80 percent confidence  
18 level, the confidence interval for the first three strata only is 57 percent. Petitioner also asserts that the  
19 amount regarded as taxable should be adjusted such that it is the amount computed using the  
20 percentage of error, reduced by the percentage of the confidence interval. To support its position,  
21 petitioner has provided evidence showing that the Internal Revenue Service and various states evaluate  
22 statistical samples at a higher confidence level and require a much lower confidence interval.

23 Petitioner does not dispute that the Department's statistical sampling was conducted in  
24 accordance with the provisions of Chapter 13 of the Sales and Use Tax Audit Manual, but disputes the  
25 validity of the Audit Manual's guidelines for statistical samples. Those guidelines were developed by  
26 the Board based on extensive research and consideration of the input of various interested parties, and  
27 were established to ensure the use of uniform procedures for all audits involving statistical sampling.  
28 The Board's statistical sampling guidelines are valid and were properly applied here, and there is no

1 basis for treating the audit of petitioner differently from audits of other taxpayers. We conclude that no  
2 adjustment is warranted, and that the claim for refund, which is based on the same grounds as the  
3 petition, should be denied.

#### 4 **RESOLVED ISSUE**

5 Since petitioner did not participate in the amnesty program, an amnesty interest penalty applies  
6 when the liability becomes final. Petitioner filed a request for relief of the amnesty interest penalty,  
7 and the Department granted relief of the penalty prior to the appeals conference. We agree, and since  
8 petitioner has already paid the tax and interest in full, the normal payment conditions for such relief  
9 have already been satisfied.

#### 10 **POST HEARING DEVELOPMENTS**

11 During the post-hearing reaudit, petitioner elected to not pursue an expansion of the original  
12 statistical sample. Accordingly, we do not recommend any adjustments to the audited amount of  
13 unreported purchases subject to use tax of \$16,999,415. However, petitioner provided evidence that it  
14 had reported use tax in error on other purchases. Specifically, petitioner provided evidence that it  
15 reported use tax on all its purchases of sodium hypochlorite (most of which it consumed in its  
16 treatment of recycled water), while it had purchased some of that product, totaling \$171,404, for resale  
17 to West Basin Municipal Water District. Petitioner also provided evidence that it had paid use tax on  
18 other nontaxable purchases, such as nontaxable labor charges. Accordingly, the Department reviewed  
19 a stratified statistical sample of petitioner's accrued use tax for possible overpayments. The  
20 Department segregated the transactions into three strata, \$1,000 to \$9,999, \$10,000 to \$99,999, and  
21 \$100,000 or greater. It reviewed all transactions greater than \$100,000 and tested the two remaining  
22 strata. Upon application of the results of its test, the Department found that petitioner had erroneously  
23 reported use tax on a measure of \$3,002,073. We recommend an adjustment of that amount, which  
24 results in an overpayment of tax of \$247,671.06. Thus, we recommend a refund of \$247,671.06, as  
25 well as any overpaid interest, and credit interest on the overpayment.

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27 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III  
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**Statistical Sample**  
**Unreported Purchases Subject to Use Tax**

Transactions Examined	Purchases subject to use tax
Confidence level	80%
Confidence interval	24.718 percent
Whether stratification was used, and if so what was stratified	Yes*
Total number of items in the population	Stratum 1 - 31,441 Stratum 2 - 29,809 Stratum 3 - 3,412 Stratum 4 - 325
Number of items randomly selected for the test	Stratum 1 - 330 Stratum 2 - 435 Stratum 3 - 350 Stratum 4 - 325
Number of errors found	Stratum 1 - None Stratum 2 - 5 Stratum 3 - 8 Stratum 4 - 9
Average dollar value of population	Stratum 1 - \$ 319.36 Stratum 2 - \$ 4,311.15 Stratum 3 - \$ 65,488.16 Stratum 4 - \$949,900.53
Dollar value of remaining errors	Stratum 1 - \$ 00.00 Stratum 2 - \$ 12,714.06 Stratum 3 - \$ 726,579.71 Stratum 4 - \$9,253,374.73
Dollar value of sample	Stratum 1 - \$ 105,897.00 Stratum 2 - \$ 1,912,934.40 Stratum 3 - \$ 23,556,900.20 Stratum 4 - \$308,717,673.70
Percentage of error	Stratum 1 - 0.0% Stratum 2 - 00.66% Stratum 3 - 3.08% Stratum 4 - 2.997% (not used because understatement based on actual review for Stratum 4)

\* Stratum 1: \$ 100.00 to \$ 699.99  
 Stratum 2: \$ 700.00 to \$ 19,999.99  
 Stratum 3: \$20,000.00 to \$299,999.99  
 Stratum 4: over \$300,000.00

**Statistical Sample**  
**Over-reported Purchases Subject to Use tax**

Transactions Examined	Over-reported purchases subject to use tax
Confidence level	80%
Confidence interval	-29.309%
Total number of items in the population	Stratum 1 - 18,814 Stratum 2 - 3,081 Stratum 3 - 199
Number of items randomly selected for the test	Stratum 1 - 325 Stratum 2 - 400 Stratum 3 - 199
Number of errors found	Stratum 1 - 38 Stratum 2 - 64 Stratum 3 - 3
Whether stratification was used, and if so what was stratified	Stratum 1 - \$ 1,000 - \$ 9,999 Stratum 2 - \$10,000 - \$99,999 Stratum 3 - \$100,000 and over
Average dollar value of population	Stratum 1 - \$ 2,987.42 Stratum 2 - \$ 28,883.21 Stratum 3 - \$284,591.04
Dollar value of remaining errors	Stratum 1 - <\$ 7,455.05> Stratum 2 - <\$ 299,215.49> Stratum 3 - \$ 150,691.50
Dollar value of sample	Stratum 1 - \$ 999,044.10 Stratum 2 - \$11,805,148.60 Stratum 3 - \$56,638,617.70
Percentage of error	Stratum 1 - <0.746%> Stratum 2 - <2.535%> Stratum 3 - 0.266%