Rulemaking File

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Sales and Use Tax

Regulation 1705 *Computers, Programs, and Data Processing*

OAL Approval

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16. Reporter's Transcript, Item J1, January 16, 2013
17. Draft Minutes, January 16, 2013, Item J1. The following items were exhibited:

State of California
Office of Administrative Law

In re: **Board of Equalization**	**NOTICE OF APPROVAL OF REGULATORY ACTION**
Regulatory Action:	**Government Code Section 11349.3**
Title 18, California Code of Regulations	**OAL File No. 2014-0313-02 S**
Adopt sections: **Amend sections: 1705** **Repeal sections:**	

The Board of Equalization proposed to amend section 1705 of title 18 of the California Code of Regulations to extend the relief of liability for the payment of sales and use taxes, including penalties and interest, when the liability resulted from the failure to make a timely return in reliance upon written advice given by the Board of Equalization to a person with shared accounting and common ownership with the audited person.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 7/1/2014.

Date: 4/2/2014

Craig S. Tarpenning
Assistant Chief Counsel

For: DEBRA M. CORNEZ
Director

Original: Cynthia Bridges
Copy: Richard Bennion

OFFICE OF ADMINISTRATIVE LAW
300 Capitol Mall, Suite 1250
Sacramento, CA 95814
(916) 323-6225 FAX (916) 323-6826

DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk JO
DATE: 4/3/2014
RE: Return of Approved Rulemaking Materials
OAL File No. 2014-0313-02S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2014-0313-02S regarding Relief From Liability).

Enclosures If this is an approved file, it contains a copy of the regulation(s) stamped "ENDORSED APPROVED" by the Office of Administrative Law and "ENDORSED FILED" by the Secretary of State. The effective date of an approved regulation is specified on the Form 400 (see item B.5). **Beginning January 1, 2013**, unless an exemption applies, Government Code section 11343.4 states the effective date of an approved regulation is determined by the date the regulation is filed with the Secretary of State (see the date the Form 400 was stamped "ENDORSED FILED" by the Secretary of State) as follows:

(1) **January 1** if the regulation or order of repeal is filed on September 1 to November 30, inclusive.
(2) **April 1** if the regulation or order of repeal is filed on December 1 to February 29, inclusive.
(3) **July 1** if the regulation or order of repeal is filed on March 1 to May 31, inclusive.
(4) **October 1** if the regulation or order of repeal is filed on June 1 to August 31, inclusive.

If an exemption applies concerning the effective date of the regulation approved in this file, then it will be specified on the Form 400. The Notice of Approval that OAL sends to the state agency will contain the effective date of the regulation. The history note that will appear at the end of the regulation section in the California Code of Regulations will also include the regulation's effective date. Additionally, the effective date of the regulation will be noted on OAL's Web site once OAL posts the Internet Web site link to the full text of the regulation that is received from the state agency. (Gov. Code, secs. 11343 and 11344.)

Please note this new requirement: Unless an exemption applies, Government Code section 11343 now requires:

1. Section 11343(c)(1): Within 15 days of OAL filing a state agency's regulation with the Secretary of State, the state agency is required to post the regulation on its Internet Web site in an easily marked and identifiable location. The state agency shall keep the regulation posted on its Internet Web site for at least six months from the date the regulation is filed with the Secretary of State.

2. Section 11343(c)(2): Within five (5) days of posting its regulation on its Internet Web site, the state agency shall send to OAL the Internet Web site link of each regulation that the agency posts on its Internet Web site pursuant to section 11343(c)(1).

STATE OF CALIFORNIA--OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2013-1014-02	2014-0313-02S	

For use by Office of Administrative Law (OAL) only

2014 MAR 13 PM 3:16

OFFICE OF ADMINISTRATIVE LAW

NOTICE

REGULATIONS

ENDORSED FILED IN THE OFFICE OF

2014 APR -2 PM 2:20

Debra Bowen

DEBRA BOWEN SECRETARY OF STATE

AGENCY WITH RULEMAKING AUTHORITY: State Board of Equalization

AGENCY FILE NUMBER (If any):

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
☐ Notice re Proposed Regulatory Action ☐ Other			

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	☐ Approved as Submitted ☐ Approved as Modified ☐ Disapproved/ Withdrawn	2013, 432	10/25/2013

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S): Relief From Liability

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S):

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT:

AMEND: 1705

REPEAL:

TITLE(S): 18

3. TYPE OF FILING

- ☒ Regular Rulemaking (Gov. Code §11346)
- ☐ Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)
- ☐ Emergency (Gov. Code, §11346.1(b))
- ☐ Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.
- ☐ Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)
- ☐ Emergency Readopt (Gov. Code, §11346.1(h))
- ☐ File & Print
- ☐ Other (Specify) _____
- ☐ Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
- ☐ Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

December 24, 2013 to January 16, 2014 CT

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

- ☒ Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))
- ☐ Effective on filing with Secretary of State
- ☐ §100 Changes Without Regulatory Effect
- ☐ Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

- ☐ Department of Finance (Form STD. 399) (SAM §6660)
- ☐ Fair Political Practices Commission
- ☐ State Fire Marshal
- ☐ Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
Richard E. Bennion	(916) 445-2130	(916) 324-3984	rbennion@boe.ca.gov

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE: Joann Richmond

DATE: March 13, 2014

TYPED NAME AND TITLE OF SIGNATORY: Joann Richmond, Chief, Board Proceedings Division

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

APR 02 2014

Office of Administrative Law

Final Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or a person with shared accounting and common ownership with the audited person or by a legal or statutory successor to those persons~~that person~~.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.

State of California

Memorandum

Board of Equalization

To : Craig Tarpenning
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814

Date: April 1, 2014

From : Richard Bennion
Regulations Coordinator
Board Proceedings Division, MIC: 80

Subject : *OAL File No. 2014-0313-02S*
Regulations 1705, *Relief From Liability*

The Office of Administrative Law (OAL) is authorized to make the following substitutions and corrections in connection with the above-referenced rulemaking file:

1. On the Form 400 in Box B4 Please add in "December 24, 2013 to January 16, 2014".

If you have any questions or comments, please notify me at (916) 445-2130 or email at Richard.Bennion@boe.ca.gov .

REB

tion of the carcinogenicity classifications used by IARC, and the *Monographs* development and peer review by the international Working Groups of scientific experts convened by IARC, may be found at the following URL: http://monographs.iarc.fr/ENG/Preamble/CurrentPreamble.pdf (IARC Preamble).

The basis for the listing of pulegone was described in a public notice published in the February 7, 2014, issue of the *California Regulatory Notice Register* (Register 2014, No. 6–Z). The title of the notice was "Notice of Intent to List Pulegone by the Labor Code Mechanism." The publication of the notice initiated a public comment period that closed on March 10, 2014. We received one public comment. Responses to that comment are posted on our website at: http://www.oehha.ca.gov/prop65/CRNR_notices/admin_listing/intent_to_list/noilLCset20 pulegone.html.

A complete, updated Proposition 65 list is published elsewhere in this issue of the *California Regulatory Notice Register* and is available on the OEHHA website at http://www.oehha.ca.gov/prop65.html.

Chemical	CAS No.	Toxicological Endpoint	Listing Mechanism[2]
Pulegone	89–82–7	cancer	LC

SUMMARY OF REGULATORY ACTIONS

REGULATIONS FILED WITH SECRETARY OF STATE

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653–7715. Please have the agency name and the date filed (see below) when making a request.

File# 2014–0313–02
BOARD OF EQUALIZATION
Relief From Liability

The Board of Equalization amended section 1705 of title 18 of the California Code of Regulations to extend the relief of liability for the payment of sales and use taxes, including penalties and interest, when the liability resulted from the failure to make a timely return in reliance upon written advice given by the Board of Equalization to a person with shared accounting and common ownership with the audited person.

Title 18
California Code of Regulations
AMEND: 1705
Filed 04/02/2014
Effective 07/01/2014
Agency Contact:
Richard E. Bennion (916) 445–2130

File#2014–0328–02
CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY
Sales and Use Tax Exclusion Program

The California Alternative Energy and Advanced Transportation Financing Authority submitted this emergency rulemaking readoption action to maintain the effectiveness of the amendments to seven sections in title 4 of the California Code of Regulations that were approved in OAL File No. 2013–0927–06E. The emergency regulations incorporated "advanced manufacturing" processes, as authorized in SB 1128 (Stats.2012, c. 677), into the existing sales and use tax exclusion program already available for manufacturers of alternative source products and advanced transportation products. The emergency regulations also clarified eligibility and evaluation criteria for reviewing applications from manufacturers of energy efficiency products, which are considered alternative source products, and make a number of administrative changes.

Title 4
California Code of Regulations
AMEND: 10030, 10031, 10032, 10033, 10034, 10035, 10036
Filed 04/03/2014
Effective 04/03/2014
Agency Contact: Alejandro Ruiz (916) 651–5101

File# 2014–0305–03
CALIFORNIA HORSE RACING BOARD
Application for License to Operate a Mini–satellite Wagering Facility

This rulemaking action increases the term of a license to operate a mini–satellite horse racing wagering facility from two years to five years, consistent with amendment of Business and Professions Code section 19605.25(h) by Senate Bill 305(Chapter 334, Statutes of 2011).

[2] Listing mechanism: LC — "Labor Code" mechanism (Labor Code sections 6382(b)(1) and (d)).

Rulemaking File Index

Title 18. Public Revenue

Sales and Use Tax

Regulation 1705, *Relief from Liability*

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2. Updated Informative Digest
3. Business Tax Committee Minutes, August 13, 2013
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   - BTC Agenda
   - Formal Issue Paper Number 13-006
   - Exhibit 1 Revenue Estimate
   - Exhibit 2 Text Regulation 1705
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5. Estimate of Cost or Savings, August 26, 2013
6. Economic and Fiscal Impact Statements, October 10, 2013
7. Notice of Publications
   - Form 400 and Notice, Publication Date October 25, 2013
   - Email sent to Interested Parties, October 25, 2013
   - CA Regulatory Notice Register 2013, Volume No. 43-Z
8. Notice to Interested Parties, October 25, 2013

   The following items are exhibited:

   - Notice of Hearing
   - Initial Statement of Reasons
   - Proposed Text of Regulation 1705
   - Regulation History
9. Statement of Compliance
10. Reporter's Transcript, Item F4, December 17, 2013
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15. Statement of Compliance
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VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on March 13, 2014 and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

March 13, 2014

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

Final Statement of Reasons for the Adoption of the
Proposed Amendments to California Code of Regulations,
Title 18, Section 1705, *Relief From Liability*

Update of Information in the Initial Statement of Reasons

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, on December 17, 2013. During the public hearing, the Board was informed that Board staff made a minor error in the text of the proposed amendments to Regulation 1705 published on the Board's website and made available to the public during the notice and comment period. Specifically, staff inadvertently failed to show that, during the August 13, 2013, Business Taxes Committee (BTC) meeting, the Board approved amendments replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as shown in the agenda for the August 13, 2013, BTC meeting attached to Formal Issue Paper 13-006 and exhibit 2 to Formal Issue Paper 13-006.

As a result, during the December 17, 2013, public hearing, the Board authorized staff to make the text of the proposed amendments to Regulation 1705 consistent with the text of the proposed amendments to Regulation 1705 that the Board approved on August 13, 2013, by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation. The Board also directed staff to make the text of the proposed amendments to Regulation 1705, with the substantially related change clearly indicated, available to the public for at least 15 days prior to adoption, as required by Government Code section 11346.8, subdivision (c).

On December 24, 2013, the Board made the revised text of the proposed amendments to Regulation 1705, with the change discussed above clearly indicated, available to the interested parties and posted the revised text on its website at www.boe.c.a.gov. During the Board's January 16, 2014, meeting, the Board unanimously voted to adopt the proposed amendments to Regulation 1705 with the change discussed above. The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on December 17, 2013, or the Board meeting on January 16, 2014, to comment on the proposed regulatory action.

The factual basis, specific purpose, and necessity for, the problem to be addressed by, and the anticipated benefits from the adoption of the proposed amendments to Regulation 1705 are the same as provided in the initial statement of reasons. The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that relief, under Revenue and Taxation Code section 6596, can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The adoption of the proposed amendments to Regulation 1705 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1705.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting the proposed amendments to Regulation 1705 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business and the Board's economic impact assessment, which determined that the Board's proposed regulatory action:

- 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; and
- Will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

The proposed regulation may affect small business.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of the proposed amendments to Regulation 1705 does not impose a mandate on local agencies or school districts.

Public Comments

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on December 17, 2013, or the Board meeting on January 16, 2014, to comment on the proposed regulatory action.

Determinations Regarding Alternatives

By its motion on January 16, 2014, the Board determined that no alternative to the proposed amendments to Regulation 1705 would be more effective in carrying out the purposes for which the amendments are proposed, would be as effective and less burdensome to affected private persons than the adopted amendments, or would be more

cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

The Board did not reject any reasonable alternatives to the proposed amendments to Regulation 1705 that would lessen any adverse impact the proposed amendments may have on small business.

No reasonable alternatives have been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

Updated Informative Digest for the State Board of Equalization's Adoption of Proposed Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, on December 17, 2013. During the public hearing, the Board was informed that Board staff made a minor error in the text of the proposed amendments to Regulation 1705 published on the Board's website and made available to the public during the notice and comment period. Specifically, staff inadvertently failed to show that, during the August 13, 2013, Business Taxes Committee (BTC) meeting, the Board approved amendments replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as shown in the agenda for the August 13, 2013, BTC meeting attached to Formal Issue Paper 13-006 and exhibit 2 to Formal Issue Paper 13-006.

As a result, during the December 17, 2013, public hearing, the Board authorized staff to make a the text of the proposed amendments to Regulation 1705 consistent with the text of the proposed amendments to Regulation 1705 that the Board approved on August 13, 2013, by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation. The Board also directed staff to make the text of the proposed amendments to Regulation 1705, with the substantially related change clearly indicated, available to the public for at least 15 days prior to adoption, as required by Government Code section 11346.8, subdivision (c).

On December 24, 2013, the Board made the revised text of the proposed amendments to Regulation 1705, with the change discussed above clearly indicated, available to the interested parties and posted the revised text on its website at www.boe.c.a.gov. Also, during the Board's January 16, 2014, meeting, the Board unanimously voted to adopt the proposed amendments to Regulation 1705 with the change discussed above.

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on December 17, 2013, or the Board meeting on January 16, 2014, to comment on the proposed regulatory action. There have not been any changes to the applicable laws or the effects of, the objectives of, and anticipated benefits from the adoption of the proposed amendments to Regulation 1705 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulatory action provides:

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture,

limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;

- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

<u>Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705</u>

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705,

subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no[t] determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language

and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and

- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

BOARD OF EQUALIZATION
BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE BETTY T. YEE, COMMITTEE CHAIR
450 N STREET, SACRAMENTO
MEETING DATE: AUGUST 13, 2013, TIME: 10:00 A.M.

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

Title: Proposed Regulation 1705, *Relief of Liability*.

Issue:

Should the Board amend Regulation 1705, *Relief of Liability*, to extend to a person section 6596 relief for reliance on a prior audit of another person if they are in the same industry, have a common controlling ownership and shared accounting functions?

Committee Discussion:

Staff introduced the issue and explained that the proposed amendments would extend relief of liability in situations involving reliance on the prior audit of another person provided they met the requirements established.

Mr. Joseph Vinatieri representing Anderson Audio Visual addressed the Board. He stated the language of the amendments were narrowly crafted by staff and believes the changes, if approved, will no longer penalize taxpayers for following erroneous advice. He thanked the Board for their time on the matter.

Ms. Mandel asked staff if there are similar regulations in the other tax programs of the Board and whether there is a plan to amend them to be consistent with the Sales and Use Tax program. Ms. Buehler of the Tax Policy Division stated amending regulations from other tax programs would be the next step after the Board approved staff recommendations.

Committee Action:

Upon motion by Mr. Horton and seconded by Ms. Mandel, without objection, the Committee approved and authorized for publication amendments to Regulation 1705, *Relief of Liability*. The Members then directed staff to amend similar regulations in other tax and fee programs. A copy of the proposed amendments to the regulation is attached.

Agenda Item No: 2

Title: Proposed Amendments to Regulation 1502, *Computers, Programs, and Data Processing*, and Report on Discussion of "Site Licenses."

Action Item 1

Proposed Amendments to Regulation 1502, *Computers, Programs, and Data Processing*.

Issue:

Request approval and authorization to publish proposed amendments to Regulation 1502, *Computers, Programs, and Data Processing,* to expressly clarify when a consumer purchases a non-custom computer program (hereafter, prewritten program) via an electronic download or load-and-leave transaction that does not include the transfer of tangible storage media, and also purchases a separate optional maintenance contract that includes the transfer of a backup copy of the same or similar prewritten program recorded on tangible storage media, then tax does not apply to the charge for the prewritten program itself, and tax applies to 50 percent of the lump-sum charge for the optional maintenance contract.

Committee Discussion:

Staff introduced the topic for discussion. Mr. Mark Nebergall, President, Software Finance and Tax Executives Council, also speaking on behalf of a broad-based California business coalition, expressed his opinion that Regulation 1502 inherently conflicts with the statutes regarding technology transfer agreements. Mr. Nebergall stated that the business community does not object to the proposed amendments but added that sellers of software do not generally package backup copies with optional maintenance contracts. Mr. Nebergall acknowledged that the proposal provides a partial resolution.

Committee Action:

Upon motion by Mr. Runner and seconded by Mr. Horton, without objection, the Committee approved and authorized for publication the proposed amendments to Regulation 1502, *Computers, Programs, and Data Processing.* A copy of the proposed amendments to Regulation 1502 is attached.

Discussion Item 1

Report on Discussion of Site Licenses.

Issue:

Report on discussions with the software industry regarding whether it is necessary for the Board to amend Regulation 1502, *Computers, Programs, and Data Processing*, to clarify that any charges for "site licenses" to use a non-custom computer program (hereafter, prewritten program) recorded on tangible storage media should be excluded from the measure of tax, and, if so, the extent of the exclusion that should be provided by the regulation.

Committee Discussion:

Staff stated that it met with interested parties to try to reach a consensus as to whether and to what extent site licenses should be excluded from the measure of tax. Staff explained that the meetings with interested parties have given staff a better understanding of the term "site license" and some of the common business practices of the software industry. Staff stated that it does not believe that the information provided thus far establishes that there are any other circumstances, which are not already described in Regulation 1502, subdivision (f)(1)(B) that would render the charges for the right to reproduce or copy a program as exempt or excluded from tax. Staff also noted that Regulation 1502, subdivision (f)(1)(B) is consistent with the Legal Department's historical treatment of site licenses. Furthermore, staff stated that it does not recommend any amendments be made to Regulation 1502 to clarify the application of tax to site licenses or define the term site license.

Staff further explained that there was a general consensus that many site license issues could be effectively addressed by clarifying the record keeping requirements and the audit verification procedures related to the nontaxable sale of prewritten programs transferred via electronic download and load-and-leave transactions. Staff stated that it is continuing to work with the interested parties to provide clarifying guidance in the Audit Manual and is optimistic that an agreement can be reached regarding reasonable audit verification procedures for establishing the nontaxable sale of prewritten programs.

Mr. Nebergall explained there is a fundamental disagreement with staff regarding whether a site license that allows a purchaser to make copies for use on other machines is a separate and distinct right. Mr. Nebergall stated that when tax is applied to all charges it is in conflict with the technology transfer agreement statutes. Mr. Nebergall indicated that the industry is moving away from providing software on tangible storage media and that this issue only arises when the initial sale of the software is on tangible media. Mr. Nebergall also requested that the Board direct staff to work on guidance regarding software sold on tangible personal property other than a separate tangible storage medium (i.e., what staff generally refers to as "embedded software").

Ms. Therese Twomey, representing the California Taxpayers Association (CalTax), explained that CalTax and the telecommunications and oil industries are working with the Property Tax Department regarding embedded software and expressed the need for guidance for sales and use tax purposes as well.

In response to the speakers' comments, staff explained that when the object of the contract is tangible personal property, a site license for the right to use that product is not a transfer of a separate and distinct right. With respect to embedded software, staff stated that property taxes and sales and use taxes are separate issues. Staff also noted that it has not expanded discussions beyond the two focused issues and acknowledged there is current ongoing litigation.

Mr. Horton stated that if the issue were bifurcated between an audit and legal issue that a possible solution could be found with audit guidance. Mr. Horton further suggested that staff develop Audit Manual guidance that will provide sample language which may be included in a sales agreement to reflect the parties' intent to transfer the software electronically without the transfer of tangible personal property. Ms. Yee directed staff to develop a timeline for the proposed audit manual guidelines and, respecting confidentiality, look at the cases currently held in abeyance, pending the technology transfer agreement issue, to determine if they may contain guidance with respect to electronic transfers of software.

/s/ Betty T. Yee

Honorable Betty T. Yee, Committee Chair

/s/ Cynthia Bridges

Cynthia Bridges, Executive Director

BOARD APPROVED
at the September 10, 2013 Board Meeting

/s/ Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Regulation 1705. *Relief of Liability.*

Reference: Section 6596, Revenue and Taxation Code.

(a) IN GENERAL. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or a person with shared accounting and common ownership with the audited person or by a legal or statutory successor to those persons.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) ADVICE PROVIDED IN A WRITTEN COMMUNICATION.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his

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

or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report~~.~~ by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

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

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) TRADE OR INDUSTRY ASSOCIATIONS OR FRANCHISORS. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific

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member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

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

Regulation 1502. *Computers, Programs, and Data Processing.*

Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

(a) In General. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) Definition of Terms.

(1) Application. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) Coding. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) Computer. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment to the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control or for the control of manufacturing machinery or equipment.

(4) Custom Computer Program and Programming. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(5) Data Entry (including Encoding). Recording information in or on storage media by punching the holes or inserting magnetic bits to represent letters, digits, and special characters.

(6) Digital Pre-Press Instruction. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(7) Input. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(8) Output. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(9) Prewritten Program. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(10) Program. "Program" is the complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions thereof. "Subdivision" includes, without limitation, assemblers, compilers, generators, procedures, functions, routines, and utility programs. "Problem" means and includes any problem that may be addressed or resolved by a program or subdivision; and the "problem" addressed need not constitute the full array of a purchaser's or user's problems, requirements, and desired features. "Problem" further includes, without limitation, any problem associated with: information processing; the manipulation or storage of data; the input or output of data; the transfer of data or programs, including subdivisions; the translation of programs, including subdivisions, into machine code; defining procedures, functions, or routines; executing programs or subdivisions that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.

(11) Proof Listing. A tabulated listing of input.

(12) Source Documents. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(13) Storage Media. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) Basic Applications of Tax.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting or otherwise physically altering, modifying or treating consumer-furnished tangible personal property

(cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication, are not subject to tax (See subdivision (i).)

(8) Generally, data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) Manipulation of Customer-Furnished Information as Sale or Service.

(1) General. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) Data Entry and Verification. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for date entry and verification, or data entry providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sale of proof lists. Charges therefor are taxable, whether the storage media are furnished by the customer or by the data processing firm. Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) Addressing (Including Labels) for Mailing. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor or such list as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing-Services.")

(4) Microfilming and Photorecording. Tax applies to charges for microfilming or photorecording except, as provided in subdivision (d)(5), where the microfilming or photorecording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photorecording paper.

(5) Processing of Customer-Furnished Information.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to another, or (4) an agreement under which a person undertakes to prepare artwork, drawings illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to

typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photorecording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as duplicate copies of storage media: inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if and), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared, the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multilithing, or by other means are subject to tax.

(e) Training Services and Materials. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) Computer Programs.

(1) Prewritten (Canned) Programs. Prewritten programs may be transferred to the customer in the form of storage media, or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched, passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) Maintenance contracts sold in connection with the sale or lease of a prewritten computer programs generally provide that the purchaser will be entitled to receive,

during the contract period, storage media on which ~~the~~ prewritten program improvements or error corrections have been recorded. The maintenance contracts may provide that the purchaser is entitled to receive storage media on which a backup copy of the same or similar prewritten program is recorded, so that the purchaser may use the backup copy to restore the prewritten program. The maintenance contract also may provide that the purchaser will be entitled to receive, during the contract period, telephone or on-site consultation services.

If the purchase of the maintenance contract is not optional with the purchaser, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or the installation of the program is a part of the sale of the computer. Paragraph (C) applies to optional software maintenance contracts sold in connection with nontaxable transactions described in this paragraph.

If the transfer of a prewritten program is a nontaxable transaction, then the seller is the consumer of tangible personal property used to produce written documentation or manuals (including documentation or manuals in machine-readable form) designed to facilitate the use of the program and transferred to the purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program.

Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable

(2) Custom Programs.

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten program are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) Service Charges. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) Pick-up and Delivery Charges. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in regulation 1628, "Transportation Charges."

(i) Rental of Computers. A lease includes a contract by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or

her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

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JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

August 2, 2013

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the August 13, 2013 Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1705, *Relief of Liability*.

Action 1 on the Agenda concerns proposed amendments to Regulation 1705 to address the extension of section 6596 relief. Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m.** on **August 13, 2013** in Room 121 at the address shown above.

Sincerely,

Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department

JLM: map

Enclosures

cc: (all with enclosures)
Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC:71)
Senator George Runner (Ret.), Member, Second District (via email)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)
Mr. David Hunter, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District

Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Mr. Alan Giorgi, Board Member's Office, Second District
Ms. Lynne Kinst, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges (MIC:73)
Mr. Randy Ferris (MIC:83)
Mr. Robert Tucker (MIC:82)
Mr. Bradley Heller (MIC:82)
Mr. Scott Claremon (MIC:82)
Mr. Lawrence Mendel (MIC:82)
Ms. Susanne Buehler (MIC:92)
Mr. Bradley Miller (MIC:92)
Ms. Kirsten Stark (MIC:50)
Mr. Clifford Oakes (MIC: 50)
Mr. Michael Patno (MIC: 50)
Ms. Lynn Whitaker (MIC:50)

AGENDA — August 13, 2013 Business Taxes Committee Meeting

Proposed Amendments to Regulation 1705, *Relief of Liability*, for the extension of section 6596 relief

Action 1 — Proposed Regulation 1705, *Relief of Liability*	
Issue Paper Alternative 1 – Staff Recommendation See Agenda, pages 2-6, and Issue Paper Exhibit 2	**Alternative 1** Approve and authorize publication of amendments to Regulation 1705, *Relief of Liability*, as agreed upon by staff and interested parties to extend section 6596 relief from a liability to a person if the liability was the result of the person relying on erroneous advice provided during the prior audit of another person if the person seeking relief meets the following criteria: 1. The person seeking relief must be engaged in the same line of business as the audited person. 2. The person seeking relief must have common verifiable controlling ownership of 50% or greater or a common majority shareholder with the audited person. 3. The person seeking relief must have shared accounting functions with the audited person. **OR**
Issue Paper Alternative 2	**Alternative 2** Do not approve and authorize publication of proposed Regulation 1705, *Relief of Liability*.

AGENDA — August 13, 2013 Business Taxes Committee Meeting

Proposed Amendments to Regulation 1705, *Relief of Liability,* for the extension of section 6596 relief

Action 1 – Staff Recommendation	**Regulation 1705. *Relief of Liability.***

(a) IN GENERAL. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or a person with shared accounting and common ownership with the audited person or by a legal or statutory successor to ~~that person~~ those persons.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction

Action 1 – Staff Recommendation	regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below. **(b) ADVICE PROVIDED IN A WRITTEN COMMUNICATION.** (1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested. (2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval: **(A)** The defined population of the purchases that will be included in the reporting method; **(B)** The percentage of purchases of the defined population that is subject to tax; **(C)** The length of time the writing shall remain in effect; **(D)** The definition of a significant or material change that will require rescinding the approved reporting

Action 1 – Staff Recommendation	method; and **(E)** Other conditions as required. The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method. **(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT.** Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report~~.~~ by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous. For the purposes of this section a person is considered to have shared accounting and common ownership if the person: (1) Is engaged in the same line of business as the audited person.

Action 1 – Staff Recommendation	(2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and (3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following: **(A)** Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation. **(B)** Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns **(C)** Shared accounting policies and procedures. These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date. **(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL.** Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if: (1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to

Action 1 – Staff Recommendation	his or her representative under the conditions set forth in subdivision (b) above; or (2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel. **(e) TRADE OR INDUSTRY ASSOCIATIONS OR FRANCHISORS.** A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation. For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Issue Paper Number **13-006**

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

Proposed Amendments to Regulation 1705, *Relief of Liability*, for the extension of Section 6596 relief

I. Issue

Should the Board revise Regulation 1705, *Relief of Liability*, to extend to a person section 6596 relief for reliance on a prior audit of another person if they are in the same industry, have a common controlling ownership and shared accounting functions?

II. Alternative 1 - Staff Recommendation

Staff recommends that the Board approve and authorize the publication of Regulation 1705, *Relief of Liability*, as proposed in Exhibit 2, to extend section 6596 relief from a liability to a person if the liability was the result of the person relying on erroneous advice provided from the prior audit of another person when:

1. The person seeking relief is engaged in the same line of business as the audited person.
2. The person seeking relief shares with the audited person common verifiable controlling ownership of 50% or greater or a common majority shareholder.
3. The person seeking relief has shared accounting functions with the audited person. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
   - Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation exists.
   - A shared accounting staff or outside firm maintains books and records and prepares sales and use tax returns.
   - Shared accounting policies and procedures exist.

The requirements must be established as existing throughout the periods for which relief is sought. In addition, staff maintains that for the same reason these related parties would reasonably rely on the original advice, they would also reasonably be expected to rely on subsequent corrective advice from the Board. Accordingly, if a written rescission is provided to the audited person or to any person with shared controlling ownership and centralized accounting functions, it will serve as notification to all parties that the prior written advice may no longer be relied upon.

III. Other Alternative(s) Considered

Do not approve proposed Regulation 1705, *Relief of Liability*.

IV. Background

Revenue and Taxation Code section 6596 provides relief from tax, interest, and penalty charges due on a transaction if the Board determines that the taxpayer failed to pay tax because it reasonably relied on erroneous written advice from the Board. For relief to apply, the Board must have received a written request for advice on the activity or transaction, the request must have identified the taxpayer to whom the advice applied, and the request must have fully described the facts and circumstances of the activity or transaction. Regulation 1705(c) states that, "[p]resentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report."

Section 6596, subdivision (d) states that "[o]nly the person making the written request shall be entitled to rely on the board's written advice to that person." Section 6005 defines a person as any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. Generally, taxpayers cannot obtain relief by relying on a written opinion given to another person, even if the transactions are similar. However, a person may rely on advice given to the person's representative provided that the representative identifies the person for whom the advice is requested.

Regulation 1705, *Relief from Liability*, explains the provisions of section 6596 in more detail. The regulation has been amended twice to explain who can rely on the written advice given. In 1999, Regulation 1705 was amended to extend section 6596 relief to trade or industry association members when an association requests written advice on behalf of its members. In 2009, the regulation was amended again to extend the relief to franchisees who relied on advice provided to their franchisor. For both, in order to obtain relief under section 6596, the members or franchisees must be identified in the association's or franchisor's request for advice, respectively. In addition, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

At its October 2012 Board Meeting, the Board heard a Sales and Use Tax appeals case for Taxpayer/Business ABC (ABC). ABC argued that they followed the advice provided during the prior audit of Taxpayer/Business XYZ (XYZ). The claimant stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Records revealed that XYZ owns more than 50% of ABC. Therefore, it was argued that advice provided to XYZ during the prior audit, was indirectly provided to ABC as well. Following the meeting, staff was asked to clarify Regulation 1705 and explain when written advice provided to a business could also be relied on by another business.

V. Discussion

<u>Can relief due to reliance on erroneous advice be extended to another person?</u>

Regulation 1705(e) extends relief to association members and franchisees in certain cases. Essentially, the association members and franchisees are considered persons who requested the advice. In that same vein, staff proposes that when a person presents its books and records during an audit, it shall be deemed to be a written request for the audit report by the audited person, as well as any person in the same industry with shared accounting functions and common ownership with the audited person. Under such circumstances, it could be argued that it would be unreasonable to have the same accounting staff, under the direction of a common controlling ownership, rely on written advice provided to the audited person

but not rely on that same advice for another person. Staff believes if the audited person and the related entity share these characteristics, as defined, then relief from the liability should apply accordingly.

The extension of relief may occur only when reliance was from a prior audit.

The proposed provisions would only apply to advice received during a prior audit. Therefore, the majority of the proposed revisions are made to subdivision (c) which is titled "*WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT.*" Staff also recommends adding language to subdivision (a)(3) to clarify that written advice provided in a prior audit may be relied upon by these related persons as well as their legal or statutory successors.

No extension of 6596 relief for reliance on erroneous advice if initiated by a written request from a person.

Relief due to reliance on erroneous advice involving written requests submitted to the Board will not be extended to these related persons since the taxpayer would be initiating contact with the Board. Such contact by a taxpayer seeking advice would require them to list the other related existing entities in their requests for them to be considered for relief. This follows current language in Regulation 1705 addressing what associations and franchisors are required to do.

What are the criteria needed for relief to be extended?

A person seeking relief must operate within the same industry and have shared accounting functions and common controlling ownership with the person audited. Common controlling ownership is defined as common ownership of 50% or greater or a common majority shareholder in each entity involved. Centralized accounting functions are described in the proposed revisions and establish that an audited person must be actively involved in the related entity's day-to-day business affairs through that common ownership or management which dictates office policies. The requirements support the contention that it is reasonable that an audited person would rely on advice provided during the audit of their related entities.

At the first interested parties meeting, a participant questioned the statement, "[t]hese elements must be established as existing at the time the written advice was provided." The participant was concerned that this provision could exclude relief to a person that was not in business during the audit period of the audited person, but who met the requirements in all other respects. The issue was discussed at the meeting and staff has revised the regulation to read that the new requirements must be established as existing throughout the periods for which relief is sought.

Interested Parties Meeting and Comments

Staff held meetings with interested parties in April and May of this year to discuss the proposed regulation revisions. At the meetings, staff addressed written comments received prior to each meeting as well as verbal suggestions to add clarifying language and make minor grammatical edits. Staff incorporated the language suggested during the May 30, 2013 meeting and redistributed the proposed regulation with the new language to those who participated in the meeting. Staff did not receive any further comments after May 30, 2013.

VI. Alternative 1 - Staff Recommendation

A. Description of Alternative 1

Staff recommends that the Board approve and authorize the publication of Regulation 1705, *Relief of Liability*, as proposed in Exhibit 2, to extend section 6596 relief from a liability to a person if the liability was the result of the person relying on erroneous advice provided from the prior audit of another person. The person seeking relief must meet the following criteria:

1. The person seeking relief must be engaged in the same line of business as the audited person.
2. The person seeking relief must share with the audited person common verifiable controlling ownership of 50% or greater or a common majority shareholder.
3. The person seeking relief must have shared accounting functions with the audited person. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
   - Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.
   - A shared accounting staff or outside firm which maintain books and records and prepares sales and use tax returns.
   - Shared accounting policies and procedures.

The new requirements must be established as existing throughout the periods for which relief is sought. In addition, staff maintains that for the same reason these related parties would reasonably rely on the original advice, they would also reasonably be expected to rely on subsequent corrective advice from the Board. Accordingly, if a written rescission is provided to the audited person or to any person with shared controlling ownership and centralized accounting functions, it will serve as notification to all parties that the prior written advice may no longer be relied upon.

B. Pros of Alternative 1

- Clarifies that section 6596 relief extends to taxpayers who would be reasonably expected to rely on the erroneous advice given during a prior audit.
- The requirement that the related person share common ownership with the audited person is specific and narrowly tailored.
- The proposed revisions are also limited to situations in which a person would reasonably be expected to rely on the erroneous advice by the provision that requires the elements to exist throughout the period for which relief is sought and that indicates that if the Board provides a written notification to the audited person or to any person with shared controlling ownership and advice may no longer be relied upon.

C. Cons of Alternative 1

The requirements that the person be engaged in the same line of business and share accounting functions are narrow.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff's recommendation does require adoption of a revised Regulation 1705, *Relief of Liability*.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1705 and thereby begin the formal rulemaking process. Staff will also notify taxpayers of the revised regulation through other outreach efforts.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation and engaging in other outreach efforts is considered routine. Any corresponding cost would be absorbed within the Board's existing budget.

2. Revenue Impact

Minimal. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

While the overall impact is minimal, taxpayers seeking section 6596 relief would have to provide sufficient documentation to allow staff to determine if they are eligible to have the relief extended to them.

H. Critical Time Frames of Alternative 1

Implementation will begin 30 days following approval of the regulation by the State Office of Administrative Law.

VII. Other Alternatives

A. Description of Alternative

Do not approve proposed Regulation 1705, *Relief of Liability*.

B. Pros of Alternative

The Board would not incur the workload associated with processing and publicizing the regulation.

C. Cons of Alternative

Taxpayers who incur liabilities because of their reasonable reliance on erroneous prior audit advice to a person within the same industry that has shared accounting functions and a common controlling ownership will continue to be denied relief under section 6596.

D. Statutory or Regulatory Change for Alternative

None.

E. Operational Impact of Alternative

None.

F. Administrative Impact of Alternative

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative

None.

H. Critical Time Frames of Alternative

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: July 24, 2013

BOARD OF EQUALIZATION
REVENUE ESTIMATE

Proposed Amendments to Regulation 1705, *Relief of Liability*, for the extension of Section 6596 relief

I. Issue

Should the Board revise Regulation 1705, *Relief from Liability*, to clarify that a business is relieved from the liability to pay tax based on erroneous advice provided in a prior audit of a different registered person operating a business in the same industry, provided that the two businesses have common controlling ownership, as specified, and shared accounting functions such that the advice provided would reasonably be relied on by both businesses?

II. Alternative 1 - Staff Recommendation

Staff recommends that the Board approve and authorize the publication of Regulation 1705, *Relief of Liability*, as proposed in Exhibit 2, to extend section 6596 relief from a liability to a person if the liability was the result of the person relying on erroneous advice provided from the prior audit of another person if the person seeking relief meets the following criteria:

1. The person seeking relief must be engaged in the same line of business as the audited person.
2. The person seeking relief must share with the audited person common verifiable controlling ownership of 50% or greater or a common majority shareholder.
3. The person seeking relief must have shared accounting functions with the audited person. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
   - Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.
   - A shared accounting staff or outside firm which maintain books and records and prepares sales and use tax returns.
   - Shared accounting policies and procedures.

The new requirements must be established as existing throughout the periods for which relief is sought. In addition, staff maintains that for the same reason these related parties would reasonably rely on the original advice, they would also reasonably be expected to rely on subsequent corrective advice from the Board. Accordingly, if a written

rescission is provided to the audited person or to any person with shared controlling ownership and centralized accounting functions, it will serve as notification to all parties that the prior written advice may no longer be relied upon.

III. Other Alternative(s) Considered

Do not approve proposed amendment to Regulation 1705, *Relief of Liability*.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

Staff recommendation will have a minimal impact on revenues because it is expected that only a small number of businesses currently excluded from section 6596 relief of liability will be extended relief. In addition, staff recommendation clarifies that section 6596 relief extends to taxpayers who would be reasonably expected to rely on the erroneous advice given during a prior audit. Staff recommendation further explains that the provisions that the related person share common ownership with the audited person are specific and narrowly tailored. Finally, staff asserts that the proposed revisions are also carefully limited to situations in which a person would reasonably be expected to rely on the erroneous advice by the provision that requires the elements to exist throughout the period for which relief is sought. Another limiting factor is the provision that if the Board provides a written notification to the audited person or to any person with shared controlling ownership and centralized accounting functions; it will serve as notification to all parties that the prior written advice may no longer be relied upon.

Other Alternatives Considered

Alternative 2 – Do not amend Regulation 1705, *Relief of Liability*.

There is nothing in alternative 2 that would impact sales and use tax revenue.

Revenue Summary

Alternative 1 – staff recommendation will have a minimal impact on revenue.

Alternative 2 – alternative 2 does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Joe Fitz, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of July 24, 2013.

REGULATION 1705. RELIEF FROM LIABILITY.

Reference: Section 6596, Revenue and Taxation Code.

(a) IN GENERAL. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or a person with shared accounting and common ownership with the audited person or by a legal or statutory successor to those persons.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) ADVICE PROVIDED IN A WRITTEN COMMUNICATION.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report~~.~~ by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) TRADE OR INDUSTRY ASSOCIATIONS OR FRANCHISORS. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

AUGUST 13, 2013

BUSINESS TAXES COMMITTEE

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

tronically signed by Kathleen Skidgel (601-100-826-6264) aa971a07-8c94-4195-9e55-0226f15cad0e

1 P R E S E N T

2

3 For the Committee: Betty T. Yee
Chair

4

5 Michelle Steel
Member

6

7 Jerome E. Horton
Member

8

9 George Runner
Member

10

11 Marcy Jo Mandel
Appearing for John
12 Chiang, State Controller
(per Government Code
13 Section 7.9)

14

Joann Richmond
15 Chief, Board Proceedings
Division

16

Board of Equalization
17 Staff: Susanne Buehler
Chief, Tax Policy
18 Division

19 Lawrence Mendel
Tax Counsel III
20 Legal Department

21 Bradley Heller
Tax Counsel IV
22 Legal Department

23

24 ---oOo---

25

26

27

28

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Mark Nebergall	12, 17
Therese Twomey	20

---oOo---

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 AUGUST 13, 2013
4 ---oOo---
5 MR. HORTON: Ms. Richmond, our next matter?
6 MS. RICHMOND: Our next item is the
7 Business Taxes Committee. Ms. Yee is the Chair of
8 that committee.
9 Ms. Yee.
10 MS. YEE: Uh, thank you, Ms. Richmond.
11 Good morning, uh, Members. Uh, we will now
12 convene the Business Taxes Committee. There are two
13 items on the committee agenda today. Item Number 1
14 is Proposed Revisions to Regulation 1705, relating
15 to relief from liability.
16 We do have one speaker for this item. Mr.
17 Vinatieri, would you please come forward, uh, while
18 the staff introduces the issue.
19 Good morning.
20 MS. BUEHLER: Good morning. I am Susanne
21 Buehler with the Sales and Use Tax Department, and
22 we have two agenda items for your consideration this
23 morning. We will take each agenda item and their
24 respective action item separately before moving to
25 the next.
26 With me for Agenda Item 1 is Mr. Lawrence
27 Mendel from our Legal Department.
28 For this agenda item we request your

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1 approval and authorization to publish proposed
2 amendments to Sales and Use Tax Regulation 1705 for
3 relief of liability. The proposed amendments extend
4 Section 6596 relief to a person who relies on advice
5 provided in a prior audit of another person.
6 The person seeking relief must be engaged
7 in the same line of business as the audited person,
8 have a verifiable controlling interest of at least
9 50 percent, or be a common majority shareholder of
10 the audited person and have shared accounting
11 functions with the audited person.
12 The requirements must be established as
13 existing for all periods in which relief is sought.
14 In addition, if any written rescission is provided
15 to the audited person regarding a prior audit, it
16 will serve as notification to all parties that the
17 prior written advice may no longer be relied upon.
18 We have one speaker on this item. And
19 after their presentation, we'd be happy to answer
20 any questions that you may have.
21 ---oOo---
22 JOE VINATIERI
23 ---oOo---
24 MS. YEE: Thank you very much, Ms. Buehler.
25 Good morning, Mr. Vinatieri.
26 MR. VINATIERI: Good morning.
27 MS. YEE: Please introduce yourself
28 formerly for the record. You have two minutes.

1 MR. VINATIERI: I'm Joe Vinatieri on behalf
2 of Bewley, Lassleben & Miller.
3 It's good to see everyone today. It has
4 been a while since I've been here and, uh, it's good
5 to see everyone.
6 I appreciate the opportunity to comment
7 this morning. I represent Anderson Audio Visual;
8 this is a case heard by this Board, as I'm sure you
9 all recall, in Culver City, uh, last September.
10 The Board heard -- held against the
11 taxpayer in that case but acknowledged the
12 unfairness of the situation under 6596/1705 and
13 directed the staff to review the situation and a
14 possible change in Regulation 1705.
15 Today is the outcome of that effort. And
16 let me just explain that incorrect advice in the
17 context of an audit is something that I see fairly
18 often. Uh, the context is usually you'll have
19 something written by an auditor, then there's a
20 follow-up audit. And the new auditor comes in and
21 says, "Oh, you're doing it incorrectly." And the
22 taxpayer says, "Well, but, I'm just doing what the
23 prior auditor told me."
24 And it's something that you're going to
25 have in a large audit program, unfortunately, but it
26 does -- does happen. And that's what happened in
27 this case.
28 Um, the language in front of you today

1 is -- is narrowly crafted. And it recognizes that
2 where taxpayers have similar businesses and the
3 ownership is similar, that those businesses may rely
4 on those audit work papers, even if incorrect, and
5 they won't be penalized for following those audit
6 work papers. They're doing what they're told to do,
7 and that's the whole point of voluntary compliance
8 and why we have audits. Unfortunately, we have
9 human beings doing audits and human beings doing --
10 being taxpayers, and so that you're going to have
11 mistakes on occasion.
12 So, what you're doing today, candidly, is
13 correct and it's within the spirit of the Taxpayers'
14 Bill of Rights. Some of us were around when 6596
15 was born. And -- and what you are doing today just
16 carries out the legislative intent and carries out
17 the intent when this Board did six -- 1705 and took
18 the context of 6596 into the audit context. That
19 was very, very important.
20 And I might add, this agency is one of the
21 few agencies in the country that recognizes prior
22 erroneous, incorrect advice and -- or reliance
23 thereon. Many states do not have a statute, let
24 alone a regulation. So this Board is to be
25 commended. I know that California gets dinged on
26 taxpayer fairness a lot of times. But this is one
27 of the areas where California is a leader.
28 Um, I want to thank the Board. I want to

1 thank the staff for the excellent work that was done
2 on this because we had to go around and around a
3 couple of times to -- to get it right. And what you
4 have in front of you is right, and it's all about
5 fairness. And we appreciate you doing this, not
6 only for this -- uh, it's going to affect this
7 taxpayer, but it's going to affect many other
8 taxpayers in the State of California for the future.
9 Thank you.
10 MS. YEE: Thank you very much,
11 Mr. Vinatieri.
12 Um, questions or comments, Members?
13 Ms. Mandel, please.
14 MS. MANDEL: Sure. Um, I can't remember
15 whether this came up when, um, the meetings were
16 going on or not, but before us we have 1502 which is
17 the sales and use tax regu- -- starting early today
18 with my voice -- regulation. But there are similar
19 regulations under the sort of conforming laws,
20 aren't there, for the other programs, the 6596? Do
21 we have other regulations that are the mirror of
22 this one for our other programs; I believe we do.
23 MR. MENDEL: Yeah.
24 MS. MANDEL: Yeah.
25 So is there -- is there a plan or thought
26 about conforming those regs? Did that --
27 MS. BUEHLER: At this point we don't have a
28 plan. But I think, with the approval of the Board

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1 today with this regulation, that would be our next
2 steps.
3 MS. MANDEL: Okay. Thank you.
4 MS. YEE: Thank you.
5 Other questions or comments, Members?
6 Mister, uh -- Mr. Horton.
7 MR. HORTON: Thank you, Madam Chair.
8 Um, I would just encourage staff to take a
9 look at the Audit Manual, just to make sure that the
10 Audit Manual reflects this change, uh, and that our
11 team members are fully aware of, um, how this
12 impacts their audit. And to the extent possible, in
13 order to ensure continuity and synergy, uh, that we
14 look at doing -- performing concurrent audits, uh,
15 when we have these -- these holding companies
16 that -- with wholly owned subsidiaries and so forth,
17 to the extent possible, and particularly when
18 there's, uh, similarities at issue. And that we
19 sort of incorporate this in the Audit Manual
20 somehow.
21 MS. YEE: Great suggestion. Thank you.
22 Other comments, Members?
23 Hearing none, do we have a motion on this
24 item?
25 MR. HORTON: So moved.
26 MS. YEE: Okay. We have a motion --
27 MS. MANDEL: Second.
28 MS. YEE: -- by Mr. Horton. Second by

1 Ms. Mandel.
2 Do we want to incorporate further direction
3 for the staff with respect to other regulations --
4 MR. HORTON: Uh --
5 MS. YEE: -- that may require similar?
6 MR. HORTON: Yes.
7 MS. YEE: Okay. Great.
8 Uh, we have a motion by Mr. Horton. Second
9 by Ms. Mandel.
10 Without objection, that motion carries.
11 And, uh -- okay. Very good.
12 MS. BUEHLER: All right.
13 MR. VINATIERI: Thank you.
14 MS. YEE: Thank you very much,
15 Mr. Vinatieri.
16 Our second item is, uh, proposed revisions
17 to Regulation 1502, relating to computers, programs
18 and data processing.
19 We have two public speakers on this item.
20 If they would please come forward. We have, uh,
21 Mr. Mark Nebergall and Ms. Therese Twomey from
22 CalTax. Please come forward while we have the, uh,
23 staff introduce the issue.
24 MS. BUEHLER: For Agenda Item 2,
25 Mr. Bradley Heller from our Legal Department is
26 joining me.
27 For this agenda item, we have one action
28 item and one item for discussions. Both of these

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1 items were the subject of separate focused
2 interested parties meet- -- interested parties
3 meetings.
4 Action 1 is regarding proposed amendments
5 to Regulation 1502, Computers, Programs and Data
6 Processing, to clarify the application of tax to
7 maintenance contracts sold in connection with
8 pre-written computer programs.
9 For the discussion item, we will report on
10 discussions with interested parties regarding
11 changes for -- charges for site licenses.
12 In Action 1 we request your approval and
13 authorization to publish proposed amendments to
14 Sales and Use Tax Regulation 1502. Staff's
15 recommended amendments include clarifying that
16 maintenance contracts, including optional contracts,
17 sold in connection with the sale or lease of a
18 pre-written computer program may include a backup
19 copy and, when an optional maintenance contracts are
20 paired with a nontaxable or electronic download or
21 load-and-leave transactions, tax applies to 50
22 percent of the lump sum charge for the maintenance
23 contract.
24 We do have speakers, and we'd be happy to
25 answer any questions you have after their
26 presentation for this agenda item.
27 MS. YEE: Great. Thank you, Ms. Buehler.
28 Uh, let's turn to the speakers. Good

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1 morning. If you'll introduce yourselves formerly
2 for the record. You'll have two minutes each.
3 ---oOo---
4 MARK NEBERGALL
5 ---oOo---
6 MR. NEBERGALL: Sure thing.
7 My name's Mark Nebergall. I'm the
8 President of the Software Finance and Tax Executives
9 Council. Uh, I'm also here representing a broad
10 business coalition that's interested in this -- in
11 these issues.
12 And just to sort of set the stage, uh, the
13 whole reason we're here is because a few years ago
14 the Court of Appeals decided a case called Nortel.
15 And in response to Nor- -- the Nortel case held that
16 the -- the Technology Transfer Agreement statutes
17 applied to sales of, uh, computer software.
18 In response to Nortel, uh, the Board
19 repealed that part of section -- of Regulation 1507
20 that said that the TTA statutes did not apply to
21 computer software.
22 Um, and that raises an inherent conflict
23 between the provisions of Regulation 1502 that says
24 that, uh, the measure of the tax applies to all
25 license fees with respect to software, and you have
26 the TTA statute that says that you should divide the
27 measure of the tax between the intangible property
28 and -- and the tangible storage medium.

1 Uh, the -- the matter on -- with regard to
2 the amendment of Regulation 1502, uh, partially
3 resolves the issue as to when a -- a, uh -- a
4 customer receives a downloaded software and also
5 receives a backup copy of the disk. The Board
6 insists that, uh, even though the sale of software
7 and the download may be a separate and distinct
8 transaction from the sale of the backup copy, that
9 the sale of the backup -- separate sale of the
10 backup copy will taint, for sales tax purposes,
11 the -- the otherwise nontaxable download.
12 Uh, the business community doesn't have any
13 objection to the proposed revision that, uh -- uh,
14 that has been recommended. We just don't feel that
15 there's a whole lot of sellers out there that
16 package, uh, backup copies of software with software
17 maintenance. Typically those were sold as part of a
18 separate transaction; that is part of the problem.
19 Um, with respect --
20 Is this discussion right now two -- is my
21 two minutes limited to the -- to the -- to the
22 Regulation 1502, or are we going to get into the --
23 the site license issue as well?
24 MS. YEE: Or are we going to -- I'm sorry?
25 MR. NEBERGALL: There's -- there's two
26 separate issues.
27 MS. YEE: Yes.
28 MR. NEBERGALL: There's the software

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1 maintenance, and there's also the, uh, the site
2 license.
3 MS. YEE: Site licenses?
4 MR. NEBERGALL: Yeah.
5 MS. BUEHLER: We will address the site
6 licenses after we're done with this.
7 MS. YEE: Yes.
8 MR. NEBERGALL: So I get an extra two
9 minutes?
10 MS. YEE: Yes. We'll come back to you with
11 that, yeah.
12 MR. NEBERGALL: Okay. Uh, I will hold my
13 fire on the site licenses then.
14 MS. YEE: Okay. Very good. Thank you.
15 Uh, next speaker. Good morning.
16 MS. TWOMEY: Good morning. Therese Twomey
17 with the California Taxpayers Association.
18 Also, I'd like to reserve my comments to
19 the site license discussion.
20 MS. YEE: Okay. Very well.
21 Um, questions or comments, Members?
22 MS. STEEL: I. --
23 MS. YEE: Ms. Steel.
24 MS. STEEL: I just want to say thank you to
25 Chairwoman Yee to initiating this because it's about
26 time to move forward and, you know, something
27 started.
28 We are now really moving fast as, uh -- as

1 fast as technology's moving forward. So I think
2 this is about time to do it and we can move little
3 more -- I mean faster than, you know, catch up with
4 technology.
5 So thank you very much working on this.
6 And, you know, we need little, uh, forward --
7 thinking forward and, you know, catch up with those
8 technologies and all these licenses, maintenance and
9 other stuffs. So thank you.
10 MS. YEE: Thank you, Ms. Steel.
11 Other comments or questions, Members?
12 Okay. Um, why don't we go ahead and take
13 action on this particular issue. Uh, is there a
14 motion?
15 MR. RUNNER: So move.
16 MS. YEE: Okay. Motion by Mr. Runner. Is
17 there --
18 MR. HORTON: Second.
19 MS. YEE: -- a second? By Mr. Horton.
20 Without objection, Members?
21 Okay. The staff recommendation on issue
22 number one is adopted.
23 Uh, why don't we move on to the site
24 license issue then.
25 MS. BUEHLER: Our final item for discussion
26 is site licenses. Staff met with interested parties
27 to reach -- to try to reach a consensus as to
28 whether, and to what extent, site licenses should be

1 excluded from the measure of tax.
2 The discussions provided staff with a
3 better understanding of the term "site license" and
4 some of the common business practices of the
5 software industry. However, staff does not believe
6 that the information provided thus far establishes
7 that there are any other circumstances not already
8 described in Regulation 1502 subdivision (f)(1)(B)
9 that would render the charges for the right to
10 reproduce or copy a program as exempt or excluded
11 from tax.
12 Furthermore, Regulation 1502 subdivision
13 (f)(1)(B) is consistent with the Legal Department's
14 historical treatment of site licenses. As a result,
15 staff does not recommend any amendments be made to
16 Regulation 1502 to clarify the application of tax to
17 site licenses or to define the term "site license."
18 There was a general consensus at the
19 June 5th, 2013 interested parties meeting that on a
20 practical level many site license issues could be
21 effectively addressed by clarifying the
22 record-keeping requirements and the audit
23 verification procedures related to the nontaxable
24 sale of pre-written programs tranferred via
25 electronic download and load-and-leave transactions.
26 Board staff is continuing to work with
27 interested parties on clarify guidance provided in
28 the Audit Manual. Staff is optimistic that an

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1 agreement can be reached regarding reasonable audit
2 verification procedures for establishing the
3 nontaxable sale of pre-written programs.
4 We'd be happy to answer any questions you
5 may have after this speaker's presentation for this
6 action item.
7 MS. YEE: Okay. Thank you, Ms. Buehler.
8 Uh, let me go back to the speakers. If,
9 uh, again, you'll reintroduce yourselves.
10 MR. NEBERGALL: Sure.
11 MS. YEE: And take two minutes each on this
12 issue.
13 ---oOo---
14 MARK NEBERGALL
15 ---oOo---
16 MR. NEBERGALL: Sure thing.
17 Mark Nebergall, President of the Software
18 Finance and Tax Executives Council. Uh, also on
19 behalf of a California business coalition.
20 Um, the business community fundamentally
21 disagrees, uh, with the -- with the staff on the
22 site license issue. And in particular, uh, in their
23 issue paper they state that the staff is not ready
24 to agree that there's necessarily a separate and
25 distinct transfer of a right to reproduce software,
26 uh, in -- in -- in -- when it's sold as a site
27 license.
28 And just so you know what a site license is

1 and how it's different from a -- a single-use
2 license, the site license allows the purchaser of
3 the copy of the software to make copies, additional
4 copies of the software, for use on other machines.
5 And we believe that that is, as a matter of law, a
6 separate and distinct intangible copyright right.
7 And the regulation that says that, uh --
8 that those are subject to tax on a hundred percent
9 of the purchase price, is not only wrong, but it's
10 in conflict with the -- the TTA statutes.
11 And we believe that there should be a
12 regulation that applies to TTA statutes to site
13 licenses. And we believe that the further work
14 should be done on that. And, uh -- but we also
15 agree that the issue only arises when the initial
16 copy of the software is sold, uh, on a tangible
17 storage medium.
18 Very, very few companies these days sell
19 copies of software on disk. As I'm sure you're all
20 aware, everybody downloads stuff. At least that's,
21 you know, the state of affairs today. And, you
22 know, the business is moving even, you know, towards
23 delivery of software functionality in the Cloud; so
24 there's not even any need to download software
25 anymore.
26 The problem that the business community
27 encounters is on audit. When software is delivered
28 electronically, there's been -- there's been

1 requests for the taxpayer to show that no disk was
2 delivered. And it's very, very difficult to prove a
3 negative.
4 We've been working with the staff on the
5 development of some changes to the Audit Manual that
6 we believe may -- may make a lot of these problems
7 go away. But it doesn't solve the legal question
8 of -- of whether a site license, when it's delivered
9 on a -- when a copy of the software is delivered on
10 a disk should be subject to tax at one hundred
11 percent.
12 MS. YEE: Thank you very much.
13 Next speaker, please.
14 MR. NEBERGALL: I've got one more thing --
15 MS. YEE: Oh, I'm sorry.
16 MR. NEBERGALL: -- I'd like to bring up.
17 There's -- there's sort of one other issue
18 hanging out there that, uh -- and it has to do with
19 what we call embedded software, where the software
20 is delivered not on a tangible storage medium but is
21 included in a -- in a piece of machinery, such as a
22 computer. We would like to see, uh, the Board
23 direct the staff to -- to conduct some, uh, some
24 work on that issue as well. It's -- it's sort of
25 what I'll call the third issue in the basket of the
26 Nortel TTA statute issues.
27 MS. YEE: Okay.
28 MR. NEBERGALL: Thank you.

1 MS. YEE: Thank you.
2 ---oOo---
3 THERESE TWOMEY
4 ---oOo---
5 MS. TWOMEY: Therese Twomey with the
6 California Taxpayers Association.
7 Uh, first of all, we wanted to clarify
8 that, although the comments made by Mr. Nebergall
9 represent the software industry, we represent a
10 broad coalition of telecom communication industry,
11 the oil refineries, as well as manufacturers, and we
12 share Mr. Nebergall's concerns about the discussions
13 and the IP meetings concerning site licenses.
14 Um, at this point we believe that the
15 discussions, the way they're going, they are
16 inconsistent with existing law. We'd like the
17 opportunity to continue working with your staff in
18 order to ensure that implementation is along the
19 lines of where the statutes currently remain.
20 Um, with regards to embedded software, I
21 know that we've been working, um, with Senator
22 Runner on the property tax side. It's clear that we
23 need guidance on the property tax side, as well as
24 the sales tax side, on embedded software.
25 And once again, we look forward to working
26 with BOE staff on both issues in both areas.
27 MS. YEE: Thank you very much,
28 Ms. Twomey.

1 Let me go back to, uh, Ms. Buehler and Mr.
2 Heller. Responses to Mr. Nebergall's comments?
3 MR. HELLER: I guess, in order, I think,
4 uh -- I guess staff and industry do have a
5 disagreement about the treatment of site licenses.
6 And I think it's -- it all -- it very much goes to
7 our fundamental understanding of what are computer
8 programs and what are -- what is the object of the
9 contract when you're purchasing a computer -- or I
10 should say a pre-written computer program on
11 tangible storage media and you're buying what
12 we've -- what we've given the name "site license"
13 meaning the right to use it on more than one
14 machine.
15 Meaning -- I think in our discussions that
16 included the situation where you have the right to
17 use it on two machines, say, your desktop and your
18 laptop. And honestly, staff really did not see any
19 information that -- that indicated that the object
20 of the contract wasn't the actual program itself and
21 the use of the program. And that all of the
22 copying, whatever copying there was, was absolutely
23 incidental to the use of the program itself. And
24 that's why we don't think that there's a separate
25 and distinct transfer.
26 However, we -- you know, we did look at
27 industry's comments. And we don't -- you know, we
28 appreciated their participation. We just -- nothing

1 in there convinced us though that there were
2 something separate and distinct in the site license
3 situation.
4 And -- and again, uh, you know, we could
5 keep looking at it. But, at this point, I don't
6 believe there's any more information that the
7 industry intends to provide or has that would
8 convince us differently. And, again, I think it
9 goes back to the fundamental understanding of what
10 that -- that computer program is.
11 MS. YEE: Mm-hmm.
12 MR. HELLER: And if it's tangible personal
13 property and the object of the contract is using
14 tangible personal property, then staff doesn't see
15 why the -- the regulation's wrong in saying charges
16 for the use of tangible personal property are
17 subject to tax.
18 If you agree with the industry that the
19 program itself is an intangible, then any charges
20 for copying your intangible or using your intangible
21 I would -- you might agree with them were not
22 subject to tax. But staff can't agree with that.
23 Um, let's see, with regard to, um, embedded
24 software, that really was not an issue that was
25 assigned to staff. But I think that also, again,
26 completely relates to how you view the software
27 itself.
28 Essentially, if -- if software transferred

1 on tangible storage media is tangible personal
2 property, then we don't know how we could see that
3 software that's embedded in actual tangible personal
4 property isn't tangible personal property itself.
5 Meaning, like, everything that's included in the box
6 that your computer seems tangible to staff, and
7 we've found no evidence to indicate otherwise. And
8 that in this area of property tax law and sales and
9 use tax law are just different in that respect.
10 MS. YEE: Right.
11 MR. HELLER: At least to this point.
12 And then, um, in addition though, staff is
13 very -- well, I should say agrees with industry that
14 today's business practices really generally don't
15 involve the transfer of programs on tangible storage
16 media when they're sold with broad site licenses,
17 for like large companies. And we do think we can be
18 successful in, uh, drafting Audit Manual guidelines
19 that will hopefully eliminate -- or I should say
20 make it more efficient so that we aren't spending
21 more time auditing transfer -- electronic transfers
22 and we're focusing on transactions where there's
23 actually a transfer of tangible personal property
24 involved.
25 Um, beyond that though, I would say also,
26 staff has really not tried to engage in discussions
27 of Technology Transfer Agreements beyond the two
28 focused issues, um, that were assigned to the

1 Business Taxes Committee. And mainly just because
2 the Board is currently engaged in litigation
3 regarding many of those issues and we're waiting to
4 see what guidance we get from the -- the courts.
5 MS. YEE: Okay. Thank you, Mr. Heller.
6 Uh, let me turn to Mr. Horton, but I think
7 with respect to the issue about embedded software,
8 Senator Runner, I'm going to look to you for, you
9 know, just maybe a --
10 MR. RUNNER: I think -- again, I think
11 we're trying to define the difference between
12 embedded software on a sales tax issue and on a
13 property tax issue.
14 MS. YEE: Right.
15 MR. RUNNER: So I think, you know, the
16 issue that we've been dealing with on the property
17 tax issue. I think the nature of this discussion is
18 more on the sales tax --
19 MS. YEE: Yeah.
20 MR. RUNNER: -- side.
21 MS. YEE: I think we're all searching to
22 see what process may be instructive --
23 MR. RUNNER: Right.
24 MS. YEE: -- to the other. So I -- I
25 didn't know if you wanted to maybe, uh, agendize an
26 update on that for the next, you know, Board
27 meeting, but it's --
28 MR. RUNNER: We -- we certainly can. We

1 obviously have been working with both industry and
2 also assessors on -- on -- on that issue.
3 There's -- again, it's a --
4 MS. YEE: Yeah.
5 MR. RUNNER: It's a tough issue to find
6 some common ground on.
7 MS. YEE: Right.
8 MR. RUNNER: And it's certainly an ongoing
9 discussion.
10 MS. YEE: Okay. Very good. Thank you.
11 Mr. Horton.
12 MR. HORTON: I think Mr. Heller may have
13 focused us in his comments, in that we may want to
14 bifurcate these issues. Uh, one being under the
15 umbrella of an audit issue, and then the other a
16 legal issue. Uh, because relative to the legal
17 position in -- in the Nortel case, I don't know that
18 there's a need for a change. And particularly when
19 you have, in today's technology, you can just walk
20 by a phone and transfer information.
21 And so, um, it is relatively easy to do
22 that. But the complexity of having to prove that
23 could be a double negative, or it could be as simple
24 of the Board and the industry coming to an agreement
25 as to what language could be codified in the
26 contract in order to reflect that, um -- that no
27 tangible personal property is transferred or
28 intended to be transferred in the acts of the -- of

1 the purchaser.

2 We can't control that. I mean, as a

3 retailer, you can't control what the purchaser

4 ultimately does and how they do that. But given

5 modern technology, I could -- you know, you could

6 transfer a program to -- with the push of a button,

7 without the use of any tangible personal property.

8 So, uh, I think if we bifurcated, we could

9 probably find the solution to the problem on the

10 audit side.

11 MS. YEE: Thank you, Mr. Horton.

12 Other comments, Members?

13 Let me weigh in a little bit on this. Uh,

14 I -- I agree with you, Mr. Horton, for the most

15 part. What I'm concerned about is really, uh,

16 obviously looking at the fact that we have still

17 related litigation in this area.

18 MR. HORTON: Mm-hmm.

19 MS. YEE: Uh, I'm wondering if what might

20 be instructive to us in terms of Audit Manual

21 changes is to look at, uh, I think some of the

22 audits that have been put on hold that are pending

23 that have some, uh -- well, pending resolution of

24 the Technology Transfer Agreement discussion, but

25 whether looking at some of those audits may provide

26 some guidance to us.

27 And I do want to put a little bit more of a

28 timeline and process on how we look at some of these

1 Audit Manual changes. I think ongoing engagement
2 with industry is always good. Uh, I -- I may want
3 to formalize this process a little bit more just
4 because, uh, it -- it seems to kind of keep hanging
5 out there. And obviously with the sensitivity about
6 other issues that are unresolved, but it seems to be
7 a good place to start might be other audits that
8 have been held in abeyance pending the TTA
9 discussion and whether that can provide us any
10 guidance with respect to the electronic transactions
11 and -- and what may, uh, be appropriate for Audit
12 Manual changes.
13 Other comments, Members?
14 Okay. Um, so I -- I'm going do ask the
15 staff to come back and propose a timeline and just
16 maybe, uh, put a little bit more clarification on
17 the process for the Audit Manual changes. And then,
18 uh, if there could be some look -- obviously, um,
19 respecting confidentiality -- of what some of the
20 pending audits may, uh, entail that could help guide
21 this process would be helpful.
22 MS. BUEHLER: Will do.
23 MS. YEE: Okay.
24 MR. HORTON: Madam Chair, if I may.
25 Um, I like -- I would also like staff to --
26 to -- to see if we can develop, uh, some safe harbor
27 language for the industry, uh, that is acceptable
28 from an audit perspective, that brings clarity, uh,

1 for the industry and, uh -- uh, in -- in regards to
2 subsequent audits.
3 MS. YEE: Thank you.
4 MR. HORTON: Thank you, Madam Chair.
5 MS. YEE: All right. Without any further
6 comment --
7 Very good. Thank you. Thank you to staff,
8 thank you to the interested parties. The Business
9 Taxes Committee is, uh, hereby adjourned.
10 MR. NEBERGALL: Thank you.
11 MS. YEE: Thank you.
12 ---oOo---
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1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, KATHLEEN SKIDGEL, Hearing Reporter for

8 the California State Board of Equalization certify

9 that on August 13, 2013 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 1 through 28 constitute

14 a complete and accurate transcription of the

15 shorthand writing.

16

17 Dated: September 3, 2013

18

19 Kathleen Skidgel

20

21 KATHLEEN SKIDGEL, CSR #9039

22 Hearing Reporter

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ronically signed by Kathleen Skidgel (601-100-826-6264) aa971a07-8c94-4195-9e55-0226f15cad0e

ESTIMATE OF COST OR SAVINGS RESULTING FROM PROPOSED REGULATORY ACTION

Proposed Amendment of Sales and Use Tax Regulation 1705, *Relief from Liability*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is 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 cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement Prepared by _____ Date 8-26-13
Richard Bennion, Regulations Coordinator

Approved by _____ Date 8/26/13
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: **SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.**

Board Proceedings Division
10/7/05

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT

(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2008)

See SAM Section 6601 - 6616 for Instructions and Code Citations

DEPARTMENT NAME	CONTACT PERSON	TELEPHONE NUMBER
State Board of Equalization	Rick Bennion	916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400		NOTICE FILE NUMBER
Title 18, Section 1705, Relief from Liability		Z

ECONOMIC IMPACT STATEMENT

A. ESTIMATED PRIVATE SECTOR COST IMPACTS (Include calculations and assumptions in the rulemaking record.)

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts businesses and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance
- ☐ g. Impacts individuals
- ☑ h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.)

h. (cont.) Please see the attached .

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: _____ Describe the types of businesses (Include nonprofits.): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): _____

5. Enter the number of jobs created: _____ or eliminated: _____ Describe the types of jobs or occupations impacted: _____

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: _____

B. ESTIMATED COSTS (Include calculations and assumptions in the rulemaking record.)

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $ _____

a. Initial costs for a small business: $ _____ Annual ongoing costs: $ _____ Years: _____

b. Initial costs for a typical business: $ _____ Annual ongoing costs: $ _____ Years: _____

c. Initial costs for an individual: $ _____ Annual ongoing costs: $ _____ Years: _____

Describe other economic costs that may occur: _____

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): $ _____

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: _____ and the number of units: _____

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $ _____

C. ESTIMATED BENEFITS (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: _____

2. Are the benefits the result of : ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $ _____

D. ALTERNATIVES TO THE REGULATION (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: $ _____	Cost: $ _____
Alternative 1:	Benefit: $ _____	Cost: $ _____
Alternative 2:	Benefit: $ _____	Cost: $ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

xplain: _____

E. MAJOR REGULATIONS (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

1. Will the estimated costs of this regulation to California business enterprises exceed $10 million ? ☐ Yes ☐ No (If No, skip the rest of this section.)

2. Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 1:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 2:	$ _____	Cost-effectiveness ratio: $ _____

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT (Indicate appropriate boxes1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in _____, Budget Act of _____ or Chapter _____, Statutes of _____

☐ b. will be requested in the _____ (FISCAL YEAR) Governor's Budget for appropriation in Budget Act of _____

☐ 2. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in _____

☐ b. implements the court mandate set forth by the _____

court in the case of _____ vs. _____

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. _____ at the _____ (DATE) election;

☐ d. is issued only in response to a specific request from the _____

_____, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the _____ (FEES, REVENUE, ETC.) authorized by Section

_____ of the _____ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

☐ 3. Savings of approximately $ _____ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

☑ 5. No fiscal impact exists because this regulation does not affect any local entity or program.

☐ 6. Other.

B. FISCAL EFFECT ON STATE GOVERNMENT *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year. It is anticipated that State agencies will:

☐ a. be able to absorb these additional costs within their existing budgets and resources.

☐ b. request an increase in the currently authorized budget level for the _____ fiscal year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any State agency or program.

☐ 4. Other.

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.

☐ 4. Other.

SIGNATURE ✍		TITLE Regulations Coordinator
AGENCY SECRETARY [1] APPROVAL/CONCURRENCE	✍ Joann Richmond	DATE 10/10/13
DEPARTMENT OF FINANCE [2] APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER ✍ Exempt under SAM section 6660	DATE

1. *The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.*

2. *Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.*

Attachment to Economic and Fiscal Impact Statement (STD. 399 (Rev. 12/2008)) for the Proposed Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

Currently, under Revenue and Taxation Code (RTC) section 6596, subdivision (a), if the State Board of Equalization (Board) finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under RTC section 6596, subdivision (c), a person requesting RTC section 6596 relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of RTC section 6596. The proposed amendments to Regulation 1705:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and

- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

As a result, the proposed amendments will permit some additional persons to qualify for RTC section 6596 relief, and choose to incur any costs associated with requesting relief under RTC section 6596, subdivision (c). However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under RTC section 6596. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

Further, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 1705. And, each person in the limited class will only be eligible for RTC section 6596 relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 1705 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for RTC section 6596 relief due to the proposed amendments.

Furthermore, the Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

Therefore, based upon the foregoing information and all of the information in the rulemaking file, 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 regulatory action, and the Board has determined that the proposed amendments to Regulation 1705:

- 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;
- 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;
- Will not have a significant effect on housing costs;

- Will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California; and
- Will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

Finally, Regulation 1705 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

STATE OF CALIFORNIA--OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2013-1014-02		

For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

OCT 14 '13 OCT 25 '13

Office of Administrative Law

NOTICE | REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY: State Board of Equalization

AGENCY FILE NUMBER (If any):

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
Relief From Liability	18	1705	October 25, 2013

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
[X] Notice re Proposed Regulatory Action [ ] Other	Rick Bennion	(916) 445-2130	(916) 324-3984

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	[ ] Approved as Submitted [ ] Approved as Modified [ ] Disapproved/ Withdrawn		

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT

AMEND

TITLE(S)

REPEAL

3. TYPE OF FILING

[ ] Regular Rulemaking (Gov. Code §11346)

[ ] Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)

[ ] Emergency (Gov. Code, §11346.1(b))

[ ] Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.

[ ] Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)

[ ] Emergency Readopt (Gov. Code, §11346.1(h))

[ ] File & Print

[ ] Other (Specify) _____

[ ] Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)

[ ] Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

[ ] Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))

[ ] Effective on filing with Secretary of State

[ ] §100 Changes Without Regulatory Effect

[ ] Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

[ ] Department of Finance (Form STD. 399) (SAM §6660)

[ ] Fair Political Practices Commission

[ ] State Fire Marshal

[ ] Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY

For use by Office of Administrative Law (OAL) only

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board. The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17-19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6596

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

> A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.
>
> For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

<u>Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705</u>

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require

that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is 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 the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7

(commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost 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

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 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 adoption of the proposed amendments to Regulation 1705 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 ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 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. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 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 the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, 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, 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:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17-19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the 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 amendments 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 the proposed amendments to Regulation 1705 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 original 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 the proposed amendments to Regulation 1705, 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*.

Bennion, Richard

From: BOE-Board Meeting Material
Sent: Friday, October 25, 2013 9:08 AM
To: Alonzo, Mary Ann (Legal); Angeja, Jeff (Legal); Angeles, Joel; Armenta, Christopher; Baetge, Michelle; Bartolo, Lynn; Bennion, Richard; Benson, Bill; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boyle, Kevin; Bridges, Cynthia; Chung, Sophia (Legal); Cruz, Giovan; Davis, Toya P.; Delgado, Maria; Duran, David; Elliott, Claudia; Epolite, Anthony (Legal); Ferris, Randy (Legal); Ford, Ladeena L; Garcia, Laura; Gau, David; Gilman, Todd; Giorgi, Alan; Giorgi, Dolores; Goehring, Teresa; Hale, Mike; Hamilton, Tabitha; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Jacobson, Andrew; Kinkle, Sherrie L; Kinst, Lynne; Kruckenberg, Kendra; Kuhl, James; Lambert, Robert (Legal); Levine, David H. (Legal); LoFaso, Alan; Madrigal, Claudia; Maeng, Elizabeth; Mandel, Marcy Jo; Matsumoto, Sid; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Oakes, Clifford; Pielsticker, Michele; Ralston, Natasha; Richmond, Joann; Riley, Denise (Legal); Salazar, Ramon; Salgado-Ponce, Sylvia; Schultz, Glenna; Shah, Neil; Silva, Monica (Legal); Singh, Sam; Smith, Kevin (Legal); Smith, Rose; Stowers, Yvette; Suero-Gabler, Cynthia; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Tucker, Robert (Legal); Vasquez, Rosalyn; Vigil, Michael; Wallentine, Sean; Whitaker, Lynn; White, Sharon; Williams, Lee; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 1705

The State Board of Equalization proposes to adopt amendments to Regulation 1705, Relief from Liability. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on Tuesday, December 17, 2013.

The proposed amendments to Regulation 1705, Relief from Liability, prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1705_2013.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Bradley Heller, Tax Counsel IV, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Bradley.Heller@boe.ca.gov, telephone (916) 323-3091, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion
Regulations Coordinator
Phone (916) 445-2130
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Richard.Bennion@boe.ca.gov

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change <Legal.Regulations@BOE.CA.GOV>
Sent: Friday, October 25, 2013 11:04 AM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 1705

The State Board of Equalization proposes to adopt amendments to Regulation 1705, Relief from Liability. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on Tuesday, December 17, 2013.

The proposed amendments to Regulation 1705, Relief from Liability, prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1705_2013.htm

Questions regarding the substance of the proposed amendments should be directed to Mr. Bradley Heller, Tax Counsel IV, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Bradley.Heller@boe.ca.gov, telephone (916) 323-3091, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

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tial for significant adverse and beneficial environmental impacts associated with the proposed regulatory action. The environmental analysis of the proposed regulatory action can be found in the ISOR.

WRITTEN COMMENT PERIOD AND SUBMITTAL OF COMMENTS

This regulatory proceeding will be conducted through the submittal of written documents. No public hearing is currently scheduled. However, a public hearing will be scheduled if any interested person or his or her duly authorized representative requests such a hearing by November 26, 2013, no later than 15 days prior to the close of the written comment period. The request must be in writing and must comply with the requirements of Government Code section 11346.8(a). If a public hearing is requested, a notice of the time, date, and place of the hearing, if requested, will be provided by separate notice.

The public comment period for this regulatory action will begin on October 28, 2013. Written comments on this regulatory proposal must be received no later than December 11, 2013, or if a hearing is conducted, at the hearing and addressed to the following:

Postal mail: Clerk of the Board,
Air Resources Board
1001 I Street,
Sacramento, California 95814

Electronic submittal: http://www.arb.ca.gov/lispub/comm/bclist.php

Please note that under the California Public Records Act (Gov. Code, § 6250 et seq.), your written and oral comments, attachments, and associated contact information (e.g., your address, phone, email, etc.) become part of the public record and can be released to the public upon request.

AUTHORITY AND REFERENCE

This regulatory action is proposed under that authority granted in the Health and Safety Code, sections 39600, 39601, and 39608. This action is proposed to implement, interpret, and make specific Health and Safety Code sections 39608, 40718, and 40925.5.

REGULATORY AMENDMENT PROCEDURES

This regulatory proceeding will be conducted in accordance with the California Administrative Procedure Act, Government Code, title 2, division 3, part 1, chapter 3.5 (commencing with section 11340).

Following the close of the comment period, the Executive Officer may adopt the regulatory language as originally proposed, or with non–substantial or grammatical modifications. The Executive Officer may also adopt the proposed regulatory language with other modifications if the text as modified is sufficiently related to the originally proposed text that the public was adequately placed on notice that the regulatory language as modified could result from the proposed regulatory action; in such event, the full regulatory text, with the modifications clearly indicated, will be made available to the public, for written comment, at least 15 days before it is adopted. The public may request a copy of the modified regulatory text, if applicable, from ARB's Public Information Office, Air Resources Board, 1001 I Street, Visitors and Environmental Services Center, First Floor, Sacramento, California 95814, (916) 322–2990.

SPECIAL ACCOMMODATION REQUEST

If you need this document in an alternate format or another language, please contact the Clerk of the Board at (916) 322–5594 or by facsimile at (916) 322–3928 no later than five (5) business days from the release date of this notice. TTY/TDD/Speech to Speech users may dial 711 for the California Relay Service.

Si necesita este documento en un formato alterno u otro idioma, por favor llame a la oficina del Secretario del Consejo de Recursos Atmosféricos al (916) 322–5594 o envíe un fax al (916) 322–3928 no menos de cinco (5) días laborales a partir de la fecha del lanzamiento de este aviso. Para el Servicio Telefónico de California para Personas con Problemas Auditivos, ó de teléfonos TDD pueden marcar al 711.

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board.

The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17–19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6596.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

> A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.
>
> For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did not determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13–006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13–006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13–006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit

report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is 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 the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non–discretionary cost 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

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 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 adoption of the proposed amendments to Regulation 1705 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 ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 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. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 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 the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323–3091, 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, 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:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279–0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17–19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the 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 amendments 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 the proposed amendments to Regulation 1705 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 original 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 the proposed amendments to Regulation 1705, 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.*

TITLE 23. DEPARTMENT OF WATER RESOURCES

ADOPTION OF REGULATIONS FOR ISSUANCE OF ENCROACHMENT PERMIT AND ENFORCEMENT OF ACCESS TO THE RIGHT–OF–WAY ALONG THE STATE WATER RESOURCES DEVELOPMENT SYSTEM

The California Department of Water Resources ("Department") proposes to adopt new regulations establishing rules and procedures for obtaining an Encroachment Permit and removal of unauthorized encroachments along the State Water Resources Development System, otherwise known as the State Water Project ("SWP"). Authority for the regulations is found in S.B. 543 (Stats. 2005, c, 263; Margett) that established Water Code sections 12899, *et seq.* The regulations, adopted pursuant to the authority of Water Code section 12899.9, will implement, interpret, or make specific

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

October 25, 2013

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board. The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17-19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6596

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;

- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

> A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific

> franchisee name(s) for whom the advice is requested for relief from liability under this regulation.
>
> For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable

reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and

common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In

addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is 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 the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost 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

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 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 adoption of the proposed amendments to Regulation 1705 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 ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 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. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of

Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 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 the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, 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, 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:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17-19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

October 25, 2013

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the 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 amendments 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 the proposed amendments to Regulation 1705 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 original 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 the proposed amendments to Regulation 1705, 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*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the December 17, 2013 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Initial Statement of Reasons for

Proposed Amendments to California Code of Regulations,

Title 18, Section 1705, *Relief From Liability*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

Revenue and Taxation Code (RTC) section 6005 defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It currently provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the State Board of Equalization (Board) finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under RTC section 6596, subdivision (c), a person requesting RTC section 6596 relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires. And, currently, RTC section 6596,

subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. The first sentence of Regulation 1705, subdivision (e), which was included in the 1999 amendments, currently provides that "[a] trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation."

Further, as relevant here, in 2009, the second sentence was added to subdivision (e) of Regulation 1705 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. The second sentence of Regulation 1705, subdivision (e), currently provides that "[a] franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation."

Furthermore, at the same time in 2009, the second paragraph was added to subdivision (e) of Regulation 1705. The second paragraph explains that "[f]or an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor."

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by

relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Proposed Amendments

Need for Clarification

During its October 23-25, 2012, Board meeting, the Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal concerned the issue of ABC's reliance on an audit report subject to the provisions of Regulation 1705, subdivision (c), not ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that if two persons in the same industry are under common ownership and share accounting functions and accounting staff, then Regulation 1705, subdivision (b) already provides a procedure for their joint representatives to request written advice from the Board that identifies both persons by name so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to

comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) requiring a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s) to specifically identify the member(s) or franchisee(s) that may rely on the written advice for RTC section 6596 relief. Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted an interest parties meeting to discuss the draft amendments in April 2013. During the meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

Business Taxes Committee staff subsequently provided its revised draft amendments to Regulation 1705 to the interested parties and conducted a second interested parties meeting in May 2013. During the meeting, staff received verbal suggestions to add clarifying language and make minor grammatical edits to its revised draft amendments. Therefore, staff made the clarifying and grammatical edits suggested during the meeting, and provided the revised drafts of staff amendments to Regulation 1705 to the interested parties that participated in the May 2013 meeting in case there was a need for further comments.

However, staff did not receive any further comments on its revised drafts of the amendments to Regulation 1705 with the edits suggested at the May 2013 interested parties meeting. Therefore, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members on August 2, 2013, for consideration at the Board's August 13, 2013, Business Taxes Committee meeting.

August 13, 2013 Business Taxes Committee Meeting

Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add the following language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief:

> For the purposes of this section a person is considered to have shared accounting and common ownership if the person:
>
> (1) Is engaged in the same line of business as the audited person,
>
> (2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and
>
> (3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
>
> > (A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.
> >
> > (B) Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns.
> >
> > (C) Shared accounting policies and procedures.
>
> These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common

ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Mr. Joseph Vinatieri of Bewley, Lassleben & Miller, LLP, appeared at the August 13, 2013, Business Taxes Committee meeting. He expressed his support for the amendments to Regulation 1705 recommended in the formal issue paper, and said the amendments are:

- Fair to taxpayers;
- Narrowly crafted to address the issue presented by the facts of ABC's appeal; and
- Consistent with the legislative intent underlying the enactment of RTC section 6596.

Therefore, at the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper.[1] The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary for the specific purpose of addressing the issue (or problem) presented by the facts of ABC's appeal (discussed above).

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The adoption of the proposed amendments to Regulation 1705 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1705.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-006, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its August 13, 2013,

[1] The Board made two minor grammatical changes to the text of the proposed amendments to Regulation 1705, subdivision (c), recommended in Formal Issue Paper 13-006 prior to beginning the rulemaking process. The Board inserted the word "has" between the words "or" and "a" in the proposed amendments adding paragraph (2) to subdivision (c). The Board also added a "s" to the end of the word "maintain" in the proposed amendments adding paragraph (3)(B) to subdivision (c).

Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1705 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1705 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, RTC section 6596, subdivision (c), currently requires a person requesting RTC section 6596 relief to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

As previously explained, the proposed amendments to Regulation 1705:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and
- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

As a result, the proposed amendments will permit some additional persons to qualify for RTC section 6596 relief, and choose to incur any costs associated with requesting relief under RTC

section 6596, subdivision (c). However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under RTC section 6596. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

Furthermore, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 1705. And, each person in the limited class will only be eligible for RTC section 6596 relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 1705 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for RTC section 6596 relief due to the proposed amendments.

Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1705 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.

In addition, Regulation 1705 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1705 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1705 may affect small businesses.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited <u>or a person with shared accounting and common ownership with the audited person</u> or by a legal or statutory successor to that person.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1705

Title: 1705, *Relief from Liability*

Preparation: Bradley Heller
Legal Contact: Bradley Heller

The proposed amendments to Regulation 1705, *Relief from Liability,* prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person.

History of Proposed Regulation:

December 17-19, 2013	Public Hearing
October 25, 2013	OAL publication date; 45-day public comment period begins; Interested Parties mailing
October 11, 2013	Notice to OAL
August 13, 2013	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor: NA
Support: NA
Oppose: NA

Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Taxes Regulation 1705, *Relief from Liability*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on October 25, 2013, 53 days prior to the public hearing.

December 11, 2013

Richard Bennion
Regulations Coordinator
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

DECEMBER 17, 2013

ITEM F4

PUBLIC HEARINGS

PROPOSED ADOPTION OF AMENDMENTS TO SALES AND USE TAX

REGULATION 1705, RELIEF FROM LIABILITY

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

Electronically signed by Kathleen Skidgel (601-100-826-6264) bc0b8f83-facb-419c-a7ea-48331508384b

1 P R E S E N T

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3 For the Board of Equalization: Jerome E. Horton
Chairman

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5 Michelle Steel
Vice-Chairwoman

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7 Betty T. Yee
Member

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9 George Runner
Member

10

11 Marcy Jo Mandel
Appearing for John
12 Chiang, State Controller
(per Government Code
13 Section 7.9)

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Joann Richmond
15 Chief, Board Proceedings
Division

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17 For Board of Equalization Staff: Bradley Heller
18 Legal Department

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1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 DECEMBER 17, 2013
4 ---oOo---
5 MR. HORTON: Ms. Richmond.
6 MS. RICHMOND: Our next item is F4,
7 Proposed Adoption of Amendments to Sales and Use Tax
8 Regulation 1705, Relief from Penal- -- from
9 Liability.
10 MR. HORTON: Mr. Heller.
11 MR. HELLER: Thank you, Chairman Horton.
12 Normally I'd be requesting that the Board
13 vote to adopt the proposed amendments to Sales and
14 Use Tax Regulation 1705, Relief From Liability.
15 However, Ms. Mandel noticed that staff inadvertently
16 made a small but important error in the text of the
17 proposed amendments made available to the public and
18 posted on the Board's --
19 MR. HORTON: We'll put this matter over to
20 our --
21 MR. HELLER: And I was just going to
22 request that the Board authorize staff to correct
23 that error and refer the rulemaking to the 15-day
24 file so that we can bring it back for adoption at
25 the January meeting.
26 MR. HORTON: January. So moved.
27 MS. YEE: I'll move it.
28 MR. HORTON: I don't know that we need a

1 motion to that. We'll just put it over to January.
2 MS. MANDEL: Yeah. No, because you got to
3 put it in the 15-day file, right?
4 MR. HORTON: 15 day?
5 MR. HELLER: Yes.
6 MR. HORTON: All right. Member Yee moves
7 to place this matter in the 15-day process. Second
8 by Member Mandel -- without objection -- and to
9 bring it back at the earliest possible State time,
10 which I would believe would be January.
11 MR. HELLER: Thank you.
12 MR. HORTON: Without objection, Members,
13 such will be the order.
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ctronically signed by Kathleen Skidgel (601-100-826-6264) bc0b8f83-facb-419c-a7ea-48331508384b

1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, KATHLEEN SKIDGEL, Hearing Reporter for

8 the California State Board of Equalization certify

9 that on December 17, 2013 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 1 through 4 constitute

14 a complete and accurate transcription of the

15 shorthand writing.

16

17 Dated: December 19, 2013

18

19

20 Kathleen Skidgel

21 KATHLEEN SKIDGEL, CSR #9039

22 Hearing Reporter

23

24

25

26

27

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Electronically signed by Kathleen Skidgel (601-100-826-6264) bc0b8f83-facb-419c-a7ea-48331508384b

2013 MINUTES OF THE STATE BOARD OF EQUALIZATION

Tuesday, December 17, 2013

F4 Proposed Adoption of Amendments to Sales and Use Tax Regulation 1705, *Relief from Liability*

Bradley Heller, Tax Counsel, Tax and Fee Programs Division, Legal Department, made introductory remarks regarding the proposed amendments to Regulation 1705, which prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person (Exhibit 12.7).

Mr. Heller described staff's recommended minor changes to the published version of the proposed amendments to Regulation 1705.

Speakers were invited to address the Board, but there were none.

Action: Upon motion of Ms. Yee, seconded by Ms. Mandel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board approved minor changes to the published version of Regulation 1705 and ordered that the changed version be placed in the 15 day file for public comment as recommended by staff.

[G1] LEGAL APPEALS MATTERS, CONSENT

With respect to the Legal Appeals Matters Consent Agenda, upon a single motion of Ms. Steel, seconded by Ms. Yee and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board made the following orders:

G1.1 Ken Keagy, 532422 (DF)
PERIOD, $
Action: Redetermine as recommended by the Appeals Division.

G1.2 Jethani & Associates, Inc., 560580, 563266, 611299 (GH)
PERIOD, $
Action: Deny the petition for rehearing as recommended by the Appeals Division.

[G2] CORPORATE FRANCHISE AND PERSONAL INCOME TAX MATTERS, CONSENT

The Board deferred consideration of the following matter: *G2.15 Jaclyn Nelson, 605359.*

With respect to the Corporate Franchise and Personal Income Tax Matters Consent Agenda, upon a single motion of Ms. Steel, seconded by Ms. Mandel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board made the following orders:

G2.1 Michael Hillman, 613263
PERIOD, $
Action: Sustain the action of the Franchise Tax Board.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
150 N STREET, SACRAMENTO, CALIFORNIA
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BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

October 25, 2013

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board. The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17-19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at *www.boe.ca.gov* at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6596

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;

- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

> A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific

> franchisee name(s) for whom the advice is requested for relief from liability under this regulation.
>
> For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable

reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and

common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In

addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is 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 the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost 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

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 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 adoption of the proposed amendments to Regulation 1705 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 ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 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. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of

Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 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 the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, 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, 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:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17-19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

October 25, 2013

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the 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 amendments 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 the proposed amendments to Regulation 1705 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 original 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 the proposed amendments to Regulation 1705, 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*.

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

Initial Statement of Reasons for

Proposed Amendments to California Code of Regulations,

Title 18, Section 1705, *Relief From Liability*

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

Revenue and Taxation Code (RTC) section 6005 defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It currently provides that the term includes "any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit."

Currently, under RTC section 6596, subdivision (a), if the State Board of Equalization (Board) finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under RTC section 6596, subdivision (c), a person requesting RTC section 6596 relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires. And, currently, RTC section 6596,

subdivision (d), generally provides that "[o]nly the person making the written request shall be entitled to rely on the [B]oard's written advice to that person."

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. The first sentence of Regulation 1705, subdivision (e), which was included in the 1999 amendments, currently provides that "[a] trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation."

Further, as relevant here, in 2009, the second sentence was added to subdivision (e) of Regulation 1705 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. The second sentence of Regulation 1705, subdivision (e), currently provides that "[a] franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation."

Furthermore, at the same time in 2009, the second paragraph was added to subdivision (e) of Regulation 1705. The second paragraph explains that "[f]or an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor."

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by

relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Proposed Amendments

Need for Clarification

During its October 23-25, 2012, Board meeting, the Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal concerned the issue of ABC's reliance on an audit report subject to the provisions of Regulation 1705, subdivision (c), not ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that if two persons in the same industry are under common ownership and share accounting functions and accounting staff, then Regulation 1705, subdivision (b) already provides a procedure for their joint representatives to request written advice from the Board that identifies both persons by name so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to

comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) requiring a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s) to specifically identify the member(s) or franchisee(s) that may rely on the written advice for RTC section 6596 relief. Therefore, staff did no determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted an interest parties meeting to discuss the draft amendments in April 2013. During the meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

Business Taxes Committee staff subsequently provided its revised draft amendments to Regulation 1705 to the interested parties and conducted a second interested parties meeting in May 2013. During the meeting, staff received verbal suggestions to add clarifying language and make minor grammatical edits to its revised draft amendments. Therefore, staff made the clarifying and grammatical edits suggested during the meeting, and provided the revised drafts of staff amendments to Regulation 1705 to the interested parties that participated in the May 2013 meeting in case there was a need for further comments.

However, staff did not receive any further comments on its revised drafts of the amendments to Regulation 1705 with the edits suggested at the May 2013 interested parties meeting. Therefore, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members on August 2, 2013, for consideration at the Board's August 13, 2013, Business Taxes Committee meeting.

August 13, 2013 Business Taxes Committee Meeting

Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add the following language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief:

> For the purposes of this section a person is considered to have shared accounting and common ownership if the person:
>
> (1) Is engaged in the same line of business as the audited person,
>
> (2) Has common verifiable controlling ownership of 50% or greater ownership or a common majority shareholder with the audited person, and
>
> (3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:
>
> > (A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.
> >
> > (B) Shared accounting staff or an outside firm who maintain books and records and prepares sales and use tax returns.
> >
> > (C) Shared accounting policies and procedures.
>
> These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common

ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Mr. Joseph Vinatieri of Bewley, Lassleben & Miller, LLP, appeared at the August 13, 2013, Business Taxes Committee meeting. He expressed his support for the amendments to Regulation 1705 recommended in the formal issue paper, and said the amendments are:

- Fair to taxpayers;
- Narrowly crafted to address the issue presented by the facts of ABC's appeal; and
- Consistent with the legislative intent underlying the enactment of RTC section 6596.

Therefore, at the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper.[1] The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary for the specific purpose of addressing the issue (or problem) presented by the facts of ABC's appeal (discussed above).

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The adoption of the proposed amendments to Regulation 1705 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1705.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-006, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its August 13, 2013,

[1] The Board made two minor grammatical changes to the text of the proposed amendments to Regulation 1705, subdivision (c), recommended in Formal Issue Paper 13-006 prior to beginning the rulemaking process. The Board inserted the word "has" between the words "or" and "a" in the proposed amendments adding paragraph (2) to subdivision (c). The Board also added a "s" to the end of the word "maintain" in the proposed amendments adding paragraph (3)(B) to subdivision (c).

Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1705 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1705 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1705 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, RTC section 6596, subdivision (c), currently requires a person requesting RTC section 6596 relief to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

As previously explained, the proposed amendments to Regulation 1705:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and
- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

As a result, the proposed amendments will permit some additional persons to qualify for RTC section 6596 relief, and choose to incur any costs associated with requesting relief under RTC

section 6596, subdivision (c). However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under RTC section 6596. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

Furthermore, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 1705. And, each person in the limited class will only be eligible for RTC section 6596 relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 1705 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for RTC section 6596 relief due to the proposed amendments.

Therefore, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1705 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.

In addition, Regulation 1705 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1705 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1705 may affect small businesses.

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited <u>or a person with shared accounting and common ownership with the audited person</u> or by a legal or statutory successor to that person.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1705

Title: 1705, *Relief from Liability*

Preparation: Bradley Heller
Legal Contact: Bradley Heller

The proposed amendments to Regulation 1705, *Relief from Liability*, prescribe the circumstances under which Revenue and Taxation Code section 6596 relief is available to a person who reasonably relies on written advice the Board provided in a prior audit of a related person.

History of Proposed Regulation:

December 17-19, 2013	Public Hearing
October 25, 2013	OAL publication date; 45-day public comment period begins; Interested Parties mailing
October 11, 2013	Notice to OAL
August 13, 2013	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA

ESTIMATE OF COST OR SAVINGS RESULTING FROM PROPOSED REGULATORY ACTION

Proposed Amendment of Sales and Use Tax Regulation 1705, *Relief from Liability*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is 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 cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement Prepared by _____ Date 8-26-13
Richard Bennion, Regulations Coordinator

Approved by _____ Date 8/26/13
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.

Board Proceedings Division
10/7/05

STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

ECONOMIC AND FISCAL IMPACT STATEMENT

(REGULATIONS AND ORDERS)

STD. 399 (REV. 12/2008)

See SAM Section 6601 - 6616 for Instructions and Code Citations

MENT NAME	CONTACT PERSON	TELEPHONE NUMBER
State Board of Equalization	Rick Bennion	916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400		NOTICE FILE NUMBER
Title 18, Section 1705, Relief from Liability		Z

ECONOMIC IMPACT STATEMENT

A. ESTIMATED PRIVATE SECTOR COST IMPACTS (Include calculations and assumptions in the rulemaking record.)

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts businesses and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance
- ☐ g. Impacts individuals
- ☑ h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.)

h. (cont.) Please see the attached.

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: _____ Describe the types of businesses (Include nonprofits.): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

ter the number of businesses that will be created: _____ eliminated: _____

plain: _____

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): _____

5. Enter the number of jobs created: _____ or eliminated: _____ Describe the types of jobs or occupations impacted: _____

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: _____

B. ESTIMATED COSTS (Include calculations and assumptions in the rulemaking record.)

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $ _____

a. Initial costs for a small business: $ _____ Annual ongoing costs: $ _____ Years: _____

b. Initial costs for a typical business: $ _____ Annual ongoing costs: $ _____ Years: _____

c. Initial costs for an individual: $ _____ Annual ongoing costs: $ _____ Years: _____

Describe other economic costs that may occur: _____

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): $ _____

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: _____ and the number of units: _____

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $ _____

C. ESTIMATED BENEFITS (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: _____

2. Are the benefits the result of : ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $ _____

D. ALTERNATIVES TO THE REGULATION (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: $ _____	Cost: $ _____
Alternative 1:	Benefit: $ _____	Cost: $ _____
Alternative 2:	Benefit: $ _____	Cost: $ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

Explain: _____

E. MAJOR REGULATIONS (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.

ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)

1. Will the estimated costs of this regulation to California business enterprises exceed $10 million ? ☐ Yes ☐ No (If No, skip the rest of this section.)

2. Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 1:	$ _____	Cost-effectiveness ratio: $ _____
Alternative 2:	$ _____	Cost-effectiveness ratio: $ _____

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT (Indicate appropriate boxes1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in _____, Budget Act of _____ or Chapter _____, Statutes of _____

☐ b. will be requested in the _____ (FISCAL YEAR) Governor's Budget for appropriation in Budget Act of _____

☐ 2. Additional expenditures of approximately $ _____ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in _____

☐ b. implements the court mandate set forth by the _____

court in the case of _____ vs. _____

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. _____ at the _____ (DATE) election;

☐ d. is issued only in response to a specific request from the _____

_____, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the _____ (FEES, REVENUE, ETC.) authorized by Section

_____ of the _____ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

Savings of approximately $ _____ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

☑ 5. No fiscal impact exists because this regulation does not affect any local entity or program.

☐ 6. Other.

B. FISCAL EFFECT ON STATE GOVERNMENT *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year. It is anticipated that State agencies will:

☐ a. be able to absorb these additional costs within their existing budgets and resources.

☐ b. request an increase in the currently authorized budget level for the _____ fiscal year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any State agency or program.

☐ 4. Other.

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.

☐ 4. Other.

SIGNATURE ✍		TITLE Regulations Coordinator
AGENCY SECRETARY [1] APPROVAL/CONCURRENCE	✍ Joann Richmond	DATE 10/10/13
DEPARTMENT OF FINANCE [2] APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER ✍ Exempt under SAM section 6660	DATE

1. *The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.*

2. *Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.*

Attachment to Economic and Fiscal Impact Statement (STD. 399 (Rev. 12/2008)) for the Proposed Amendments to California Code of Regulations, Title 18, Section 1705, *Relief From Liability*

Currently, under Revenue and Taxation Code (RTC) section 6596, subdivision (a), if the State Board of Equalization (Board) finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person's failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board's written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board's earlier written advice ceased to be valid due to a change in the law.

In addition, under RTC section 6596, subdivision (c), a person requesting RTC section 6596 relief is currently required to file with the Board a copy of the person's written request to the Board for advice, a copy of the written advice the Board provided in response, the person's statement under penalty of perjury setting forth the facts on which the person's request for relief is based, and any other information the Board requires.

California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, implements, interprets, and makes specific the provisions of RTC section 6596. The proposed amendments to Regulation 1705:

- Clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person";
- Clarify that written advice provided in an audit may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person";
- Clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person; and

- Require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief.

As a result, the proposed amendments will permit some additional persons to qualify for RTC section 6596 relief, and choose to incur any costs associated with requesting relief under RTC section 6596, subdivision (c). However, the proposed amendments do not require any person to rely on another person's audit report or file a request for relief under RTC section 6596. Therefore, the proposed amendments do not impose any costs on any persons, including businesses.

Further, there is a limited class of persons that will actually have the shared accounting and common ownership with one or more other persons described in the proposed amendments to Regulation 1705. And, each person in the limited class will only be eligible for RTC section 6596 relief due to the person's reliance on another person's audit report during the periods that the person actually has the shared accounting and ownership with the other person and actually relies on the other person's audit report. Therefore, the proposed amendments to Regulation 1705 will provide some relief to some of the persons in the limited class described above. However, the proposed amendments will not benefit every person in the limited class described above, they will not have any impact on persons that are not part of the limited class described above, and the Board does not anticipate receiving a significant number of new requests for RTC section 6596 relief due to the proposed amendments.

Furthermore, the Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

Therefore, based upon the foregoing information and all of the information in the rulemaking file, 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 regulatory action, and the Board has determined that the proposed amendments to Regulation 1705:

- 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;
- 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;
- Will not have a significant effect on housing costs;

- Will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California; and
- Will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

Finally, Regulation 1705 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
916-445-2130 • FAX 916-324-3984
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BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

December 24, 2013

To Interested Parties:

Notice of Proposed Regulatory Action
The State Board of Equalization Proposes to Adopt Amendments to
California Code of Regulations, Title 18,
Section 1705, *Relief From Liability*

On December 17, 2013, the State Board of Equalization (Board) held a public hearing regarding the adoption of the proposed amendments to California Code of Regulations, title 18, section (Regulations) 1705, *Relief From Liability*. During the public hearing, the Board was informed that Board staff made a minor error in the text of the proposed amendments to Regulation 1705 published on the Board's website and made available to the public during the notice and comment period. Specifically, staff inadvertently failed to show that, during the August 13, 2013, Business Taxes Committee (BTC) meeting, the Board approved amendments replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as shown in the agenda for the BTC meeting attached to Formal Issue Paper 13-006 and exhibit 2 to Formal Issue Paper 13-006.

As a result, during the December 17, 2013, public hearing, the Board authorized staff to make the text of the proposed amendments to Regulation 1705 consistent with the text of the proposed amendments to Regulation 1705 that the Board approved on August 13, 2013, by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation. The Board also directed staff to make the text of the proposed amendments to Regulation 1705, with the change clearly indicated, available to the public for at least 15 days, as required by Government Code section 11346.8, subdivision (c).

Enclosed Text

Enclosed is a revised underscore and strikeout version of the text of the proposed amendments to Regulation 1705 with the change the Board authorized on December 17, 2013, clearly indicated. The text proposed to be deleted from and added to the original text of the proposed amendments to subdivision (a) of Regulation 1705 is shown in double strikeout and double underline, respectively.

Additional Comments Regarding Proposed Amendments

In accordance with Government Code section 11346.8, subdivision (c), the revised version of the text of the proposed amendments to Regulation 1705 is being placed in the rulemaking file and mailed to interested parties who commented orally or in writing, or who asked to be informed of such revisions. If you wish to review the rulemaking file, it is available for your inspection at the State Board of Equalization, 450 N Street, Sacramento, CA 95814.

The Board will discuss and may potentially adopt the revised version of the text of the proposed amendments to Regulation 1705 during its January 16-17, 2014, Board meeting in Sacramento, California. The specific agenda for the January 16-17, 2014, Board meeting will be available on the Board's Website at www.boe.ca.gov at 5:00 p.m. on January 3, 2014.

Any interested person may appear during the Board's discussion of the revised version of the text of the proposed amendments to Regulation 1705 during the January 16-17, 2014, Board meeting and present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments for the Board's consideration. In addition, any interested person may also submit written comments regarding the Board's proposed adoption of the revised version of the text of the proposed amendments to Regulations 1705. The written comment period closes at 9:30 a.m. on January 16, 2014, or as soon thereafter as the Board commences its discussion of the revised version of the text of the proposed amendments to Regulation 1705 during the January 16-17, 2014, Board meeting.

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 revised version of the text of the proposed amendments to Regulation 1705. Furthermore, any written comments received prior to the end of the written comment period must be responded to in the final statement of reasons required by Government Code section 11346.9.

Questions regarding the substance of the revised version of the text of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, 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 January 16-17, 2014, Board meeting, inquiries concerning the proposed administrative action, and requests for notice of the January 16-17, 2014, Board meeting should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (91 6) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80 I 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Interested persons may also subscribe to receive notice of all the Board's meetings via email or the United States Postal Service on the Board's website at www.boe.ca.gov/agenda/

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the January 16, 2014 Board Meeting

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited <u>or a person with shared accounting and common ownership with the audited person</u> or by a legal or statutory successor to <u>those persons</u>~~that person~~.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.

Bennion, Richard

From: BOE-Board Meeting Material
Sent: Tuesday, December 24, 2013 11:30 AM
To: Alonzo, Mary Ann (Legal); Angeja, Jeff (Legal); Angeles, Joel; Armenta, Christopher; Baetge, Michelle; Bartolo, Lynn; Bennion, Richard; Benson, Bill; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boyle, Kevin; Bridges, Cynthia; Brown, Michele C; Chung, Sophia (Legal); Cruz, Giovan; Davis, Toya P.; Delgado, Maria; Duran, David; Elliott, Claudia; Epolite, Anthony (Legal); Ferris, Randy (Legal); Ford, Ladeena L; Garcia, Laura; Gau, David; Gilman, Todd; Giorgi, Alan; Giorgi, Dolores; Goehring, Teresa; Hale, Mike; Hamilton, Tabitha; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Jacobson, Andrew; Kinkle, Sherrie L; Kinst, Lynne; Kruckenberg, Kendra; Kuhl, James; Lambert, Gary; Lambert, Robert (Legal); Levine, David H. (Legal); LoFaso, Alan; Madrigal, Claudia; Mandel, Marcy Jo; Matsumoto, Sid; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Oakes, Clifford; Pielsticker, Michele; Ralston, Natasha; Richmond, Joann; Riley, Denise (Legal); Salazar, Ramon; Salgado-Ponce, Sylvia; Schultz, Glenna; Shah, Neil; Silva, Monica (Legal); Singh, Sam; Smith, Kevin (Legal); Smith, Rose; Stowers, Yvette; Suero-Gabler, Cynthia; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Tucker, Robert (Legal); Vasquez, Rosalyn; Vigil, Michael; Wallentine, Sean; Whitaker, Lynn; White, Sharon; Williams, Lee; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 1705

The State Board of Equalization held a public hearing regarding the adoption of the proposed amendments to Regulation 1705, Relief from Liability, on December 17, 2013. During the public hearing, the Board authorized staff to correct a minor error in the text of the proposed amendments by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as described in the 15-day file letter attached below. The revised text of the proposed amendments to Regulation 1705 will be placed on the Board's agenda for consideration and potential adoption in Room 121, 450 N Street, Sacramento, at 9:30 a.m., on January 16, 2014, or as soon thereafter as the matter may be heard during the Board's January 16-17, 2014, meeting.

To view the 15-day file letter and revised text showing the changes click on the following link:
http://www.boe.ca.gov/regs/reg_1705_2013.htm

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the January 16-17, 2014, meeting, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Questions regarding the substance of the proposed amendments should be directed to Mr. Bradley Heller, Tax Counsel IV, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Bradley.Heller@boe.ca.gov, telephone (916) 323-3091, or FAX (916) 323-3387.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion
Regulations Coordinator
Phone (916) 445-2130
Fax (916) 324-3984
Richard.Bennion@boe.ca.gov

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change <Legal.Regulations@BOE.CA.GOV>
Sent: Tuesday, December 24, 2013 11:36 AM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 1705

The State Board of Equalization held a public hearing regarding the adoption of the proposed amendments to Regulation 1705, *Relief from Liability*, on December 17, 2013. During the public hearing, the Board authorized staff to correct a minor error in the text of the proposed amendments by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as described in the 15-day file letter attached below. The revised text of the proposed amendments to Regulation 1705 will be placed on the Board's agenda for consideration and potential adoption in Room 121, 450 N Street, Sacramento, at 9:30 a.m., on January 16, 2014, or as soon thereafter as the matter may be heard during the Board's January 16-17, 2014, meeting.

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Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Tax Regulation 1705, *Relief from Liability*, did comply with the provision of Government Code section 11346.8(c) and section 44 of Title 1, California Code of Regulations. The 15-day letter and the changed version of Regulation 1705 was mailed on December 24, 2013, to interested parties who commented orally or in writing or that requested such information and were made available for public comment from December 24, 2013 to January 16, 2014, a period of 13 days prior to the public hearing.

January 15, 2014

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

JANUARY 16, 2014

CHIEF COUNSEL MATTERS

J RULEMAKING

J1 PROPOSED ADOPTION OF REVISED AMENDMENTS TO SALES AND USE TAX REGULATION 1705, RELIEF FROM LIABILITY

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

ctronically signed by Kathleen Skidgel (601-100-826-6264) 52824177-f640-4bc7-9994-be6172e2d862

1 P R E S E N T

2

3 For the Board of Equalization: Jerome E. Horton
Chairman

4

5 Michelle Steel
Vice-Chairwoman

6

7 Betty T. Yee
Member

8

9 George Runner
Member

10

11 Marcy Jo Mandel
Appearing for John
12 Chiang, State Controller
(per Government Code
13 Section 7.9)

14

Joann Richmond
15 Chief
Board Proceedings
16 Division

17 For Board of Equalization Staff: Bradley Heller
18 Legal Department

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20 ---oOo---

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ctronically signed by Kathleen Skidgel (601-100-826-6264) 52824177-f640-4bc7-9994-be6172e2d862

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 JANUARY 16, 2014
4 ---oOo---
5 MR. HORTON: Ms. Richmond.
6 MS. RICHMOND: Our next item is Chief
7 Counsel Matters. Item J Rulemaking; J1 Proposed
8 Adoption of Revised Amendments to Sales and Use Tax
9 Regulation 1705, Relief from Liability.
10 MR. HORTON: Thank you. We'd ask staff to
11 introduce themselves for the record and please
12 present.
13 MR. HELLER: Good afternoon, Chairman
14 Horton. I'm Bradley Heller from the Board's Legal
15 Department.
16 I'm here to request that the Board vote to
17 adopt the proposed amendments to Sales and Use Tax
18 Regulation 1705, Relief from Liability, with the
19 changes that the Board authorized in December.
20 The proposed amendments prescribe the
21 circumstances under which a person can reasonably
22 rely upon written advice from the Board provided in
23 an audit of a related person for relief from
24 liability under Revenue and Taxation Code Section
25 6596.
26 The Board has not received any written
27 comments, and I'm available to answer any questions
28 you may have.

ctronically signed by Kathleen Skidgel (601-100-826-6264) 52824177-f640-4bc7-9994-be6172e2d862

1 MR. HORTON: Thank you very much.
2 Discussion, Members?
3 MS. YEE: Move to adopt.
4 MR. HORTON: Moved by Member Steel to
5 adopt. Second by Member Yee.
6 Without objection, Members, such will be
7 the order.
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1 REPORTER'S CERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, KATHLEEN SKIDGEL, Hearing Reporter for

8 the California State Board of Equalization certify

9 that on January 16, 2014 I recorded verbatim, in

10 shorthand, to the best of my ability, the

11 proceedings in the above-entitled hearing; that I

12 transcribed the shorthand writing into typewriting;

13 and that the preceding pages 1 through 4 constitute

14 a complete and accurate transcription of the

15 shorthand writing.

16

17 Dated: January 22, 2014

18

19

20 Kathleen Skidgel

21 KATHLEEN SKIDGEL, CSR #9039

22 Hearing Reporter

23

24

25

26

27

28

:tronically signed by Kathleen Skidgel (601-100-826-6264) 52824177-f640-4bc7-9994-be6172e2d862

2014 MINUTES OF THE STATE BOARD OF EQUALIZATION

Thursday, January 16, 2014

TAX PROGRAM NONAPPEARANCE MATTERS NOT SUBJECT TO CONTRIBUTION DISCLOSURE STATUTE

[I2] OFFER-IN-COMPROMISE RECOMMENDATIONS

Action: Upon motion of Ms. Steel, seconded by Ms. Yee and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board approved the Offer in Compromise Recommendations of *1 Deepak Chopra; 2 Gasa Investments Corporation; 3a Gerardo Cipres; 3b Celia Cipres; 4 Victor L. Lucero and Gail Lucero; 5 James Jason Conlin; 6 Esprit US Retail Limited; 7a Marshall Jordan; 7b Ruth Jordan; 8 Sam Ayesh; 9 Kemal Dogan;* and, *10 Stephen Wayne Sundes;* as recommended by staff.

[I3] LOCAL TAX REALLOCATION MATTERS

I3.1 Cities of Fontana, Lathrop and San Bernardino, 435564

Speaker: Robert Cendejas, Attorney, representing City of Ontario

1-1-06 to Current, $17,128,424.00 Tax
Considered by the Board: Summary Decision (Rev. & Tax. Code, § 40).
Action: Upon motion of Ms. Yee, seconded by Mr. Runner and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board adopted the written summary decision as amended.

CHIEF COUNSEL MATTERS

[J] RULEMAKING

J1 Proposed Adoption of Revised Amendments to Sales and Use Tax Regulation 1705, *Relief from Liability*

Bradley Heller, Tax Counsel, Tax and Fee Programs Division, Legal Department made introductory remarks regarding the request for adoption of proposed amendments to Regulation 1705 with the change authorized on December 17, 2013 (Exhibit 1.2).

Action: Upon motion of Ms. Steel, seconded by Ms. Yee and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board adopted the revised amendments to Sales and Use Tax Regulation 1705, *Relief from Liability*.

ADMINISTRATIVE SESSION

[N] ADMINISTRATIVE MATTERS, CONSENT

With respect to the Administrative Matters, Consent Agenda, upon a single motion of Mr. Runner, seconded by Ms. Steel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board made the following orders:

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80
916-445-2130 • FAX 916-324-3984
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

December 24, 2013

To Interested Parties:

Notice of Proposed Regulatory Action
The State Board of Equalization Proposes to Adopt Amendments to
California Code of Regulations, Title 18,
Section 1705, *Relief From Liability*

On December 17, 2013, the State Board of Equalization (Board) held a public hearing regarding the adoption of the proposed amendments to California Code of Regulations, title 18, section (Regulations) 1705, *Relief From Liability*. During the public hearing, the Board was informed that Board staff made a minor error in the text of the proposed amendments to Regulation 1705 published on the Board's website and made available to the public during the notice and comment period. Specifically, staff inadvertently failed to show that, during the August 13, 2013, Business Taxes Committee (BTC) meeting, the Board approved amendments replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as shown in the agenda for the BTC meeting attached to Formal Issue Paper 13-006 and exhibit 2 to Formal Issue Paper 13-006.

As a result, during the December 17, 2013, public hearing, the Board authorized staff to make the text of the proposed amendments to Regulation 1705 consistent with the text of the proposed amendments to Regulation 1705 that the Board approved on August 13, 2013, by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation. The Board also directed staff to make the text of the proposed amendments to Regulation 1705, with the change clearly indicated, available to the public for at least 15 days, as required by Government Code section 11346.8, subdivision (c).

Enclosed Text

Enclosed is a revised underscore and strikeout version of the text of the proposed amendments to Regulation 1705 with the change the Board authorized on December 17, 2013, clearly indicated. The text proposed to be deleted from and added to the original text of the proposed amendments to subdivision (a) of Regulation 1705 is shown in double strikeout and double underline, respectively.

Additional Comments Regarding Proposed Amendments

In accordance with Government Code section 11346.8, subdivision (c), the revised version of the text of the proposed amendments to Regulation 1705 is being placed in the rulemaking file and mailed to interested parties who commented orally or in writing, or who asked to be informed of such revisions. If you wish to review the rulemaking file, it is available for your inspection at the State Board of Equalization, 450 N Street, Sacramento, CA 95814.

The Board will discuss and may potentially adopt the revised version of the text of the proposed amendments to Regulation 1705 during its January 16-17, 2014, Board meeting in Sacramento, California. The specific agenda for the January 16-17, 2014, Board meeting will be available on the Board's Website at www.boe.ca.gov at 5:00 p.m. on January 3, 2014.

Any interested person may appear during the Board's discussion of the revised version of the text of the proposed amendments to Regulation 1705 during the January 16-17, 2014, Board meeting and present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments for the Board's consideration. In addition, any interested person may also submit written comments regarding the Board's proposed adoption of the revised version of the text of the proposed amendments to Regulations 1705. The written comment period closes at 9:30 a.m. on January 16, 2014, or as soon thereafter as the Board commences its discussion of the revised version of the text of the proposed amendments to Regulation 1705 during the January 16-17, 2014, Board meeting.

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 revised version of the text of the proposed amendments to Regulation 1705. Furthermore, any written comments received prior to the end of the written comment period must be responded to in the final statement of reasons required by Government Code section 11346.9.

Questions regarding the substance of the revised version of the text of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, 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 January 16-17, 2014, Board meeting, inquiries concerning the proposed administrative action, and requests for notice of the January 16-17, 2014, Board meeting should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (91 6) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80 I 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Interested persons may also subscribe to receive notice of all the Board's meetings via email or the United States Postal Service on the Board's website at www.boe.ca.gov/agenda/

Sincerely,

Joann Richmond

Joann Richmond, Chief
Board Proceedings Division

JR:reb

Text of Proposed Amendments to

California Code of Regulations, Title 18, Section 1705

1705. Relief From Liability.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit ~~of that person~~ under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited <u>or a person with shared accounting and common ownership with the audited person</u> or by a legal or statutory successor to <u>those persons</u>~~that person~~.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

(A) The defined population of the purchases that will be included in the reporting method;

(B) The percentage of purchases of the defined population that is subject to tax;

(C) The length of time the writing shall remain in effect;

(D) The definition of a significant or material change that will require rescinding the approved reporting method; and

(E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in 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 for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

For the purposes of this section a person is considered to have shared accounting and common ownership if the person:

(1) Is engaged in the same line of business as the audited person,

(2) Has common verifiable controlling ownership of 50% or greater ownership or has a common majority shareholder with the audited person, and

(3) Shares centralized accounting functions with the audited person. The audited person routinely follows the same business practices that are followed by each entity involved. Evidence that may indicate sharing of centralized accounting functions includes, but is not limited to, the following:

(A) Quantifiable control of the accounting practices of each business by the common ownership or management that dictates office policies for accounting and tax return preparation.

(B) Shared accounting staff or an outside firm who maintains books and records and prepares sales and use tax returns.

(C) Shared accounting policies and procedures.

These requirements must be established as existing during the periods for which relief is sought. A subsequent written notification stating that the advice was not valid at the time it was issued or was subsequently rendered invalid to any party with shared accounting and common ownership, including the audited party, serves as notification to all parties with shared accounting and common ownership, including the audited party, that the prior written advice may not be relied upon as of the notification date.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations or Franchisors. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6596, Revenue and Taxation Code.