

Memorandum

To : Ms. Cynthia Bridges
Executive Director (MIC:73)

Date: July 3, 2013

From : Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department (MIC:43)

Susanne Buehler for Jeffrey L. McGuire

Subject : Board Meeting August 13-15, 2013
Item N: Administrative Agenda
Proposed Revision to Audit Manual Chapter 1, General Information

In accordance with the established procedures for audit and compliance manual revisions, I am submitting proposed new Audit Manual (AM) section 0101.22, *Standard of Proof*, (Exhibit 1) and request your approval to forward it to the Board Proceedings Division for placement on the next Administrative Agenda as a consent item.

The proposed AM section was initially reviewed and approved by SUTD management, provided to Board Members, and posted at <http://www.boe.ca.gov/sutax/pmr.htm> to solicit comments from interested parties. Staff received comments from Mr. Jesse McClellan, McClellan Davis LLC, in a letter dated March 26, 2013, requesting that staff consider his suggestions to clarify the meaning and application of the preponderance standard (Exhibit 2).

After careful consideration of Mr. McClellan's comments, staff agreed with Mr. McClellan to revise the initial proposed section. For illustrative purposes, staff prepared Exhibit 3 which shows the initial proposed section in plain text with the subsequent revisions identified with strikethrough/underline text. If you have any questions, please contact me or Ms. Susanne Buehler at 324-1825.

JLM:rsw

Attachments

Approved:

STATE BOARD OF EQUALIZATION



BOARD APPROVED

At the August 13, 2013 Board Meeting

Joann Richmond
Joann Richmond, Chief
Board Proceedings Division

Cynthia Bridges
Ms. Cynthia Bridges
Executive Director

cc: (all with attachments)

Mr. Robert Tucker (MIC:82)

Mr. Wayne Mashihara (MIC:46)

Ms. Susanne Buehler (MIC:92)

Mr. Kevin Hanks (MIC:49)

STANDARD OF PROOF**0101.22**

Pursuant to Revenue and Taxation Code (RTC) section 6091, it is presumed that all gross receipts are subject to tax until the contrary is established. The effect of this rebuttable presumption is to impose upon the taxpayer the burden of proving that its gross receipts are not subject to tax. Similarly, with respect to transactions subject to use tax, the taxpayer bears the burden of proving that tax does not apply. (See, e.g. RTC § 6241, 6248.) In cases where civil tax fraud is not involved, the BOE applies the preponderance of evidence standard of proof. This is the burden of proof as specified by Evidence Code (EC) section 115 and applied by the courts in sales and use tax matters not involving civil tax fraud. (See *Maganini v. Quinn* (1950) 99 Cal. App. 2d 1, 7-8, and *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal. App. 3d 739, 748-749.)

The “preponderance of evidence” standard relates to the probability of truth, and can be defined as, “such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth” or, more succinctly, “more likely to be true than not true.” (1 Witkin, Cal. Evidence (4th ed. 2010) Burden, § 35; CACI 200.) The preponderance of the evidence standard does not require that the existence or nonexistence of a fact be proven by clear or convincing evidence or beyond a reasonable doubt; rather, it simply requires proof that the existence or nonexistence of a fact is more probable than not.

“Evidence” means testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact (EC § 140). A “presumption” is an assumption of fact that the law requires to be made from another fact or group of facts found or otherwise established in the action. A presumption is not evidence (EC § 600).

Pursuant to RTC sections 7053 and 7054, it is the responsibility of the taxpayer to maintain and make available for examination all records and other pertinent documents necessary to determine the correct tax liability. In performing an audit or other examination, staff should communicate with the taxpayer and/or its authorized representative to the fullest extent possible in an effort to establish facts that are relevant for sales and use tax audit purposes. When applying the preponderance of evidence standard, it is important that staff view all evidence in an objective manner, focusing on the quality of the evidence (i.e., original source documentation) and its probable truth or accuracy, and not only on the quantity of evidence produced. There should be no preference assigned to evidence supporting the application of tax over similar evidence which weighs against the application of tax, unless the auditor has a reasonable basis for considering it to be more persuasive.

For transactions determined to be taxable by the auditor, the auditor must make detailed comments in the audit workpapers describing the evidence reviewed and his or her conclusions. If the auditor has a reasonable basis to believe that certain evidence is not credible, the auditor must also make detailed comments in the audit work papers in support of his or her conclusion in that respect. The failure to include such comments does not deem the evidence credible and has no evidentiary impact. However, the auditor may later be required to support his or her conclusions.



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Ms. Susanne Buehler, Chief
State Board of Equalization
Tax Policy Division

VIA Email: AM.RevisionSuggestions@boe.ca.gov

Re: Audit Manual Addition
Section 0101.22, Standard of Proof

Dear Ms. Buehler:

This submission is being made in relation to the Sales and Use Tax Department's (SUTD) proposal for the addition to the Audit Manual (AM) of section 0101.22, Standard of Proof. We thank you for the opportunity to present our comments and hope the following is useful in establishing comprehensive guidelines. Prior to addressing each suggestion, however, we believe some background to this process will provide some beneficial context.

In performing sales and use tax related services on behalf of our clients, we recognized what we perceived to be inconsistencies in the application of the standard of proof by the audit staff. Upon inquiry, it was revealed that the audit staff in general was unfamiliar with the preponderance of evidence standard. Our subsequent requests to the SUTD for its written policy on the preponderance of evidence standard revealed that no such written policy existed.

In response to our expressed concerns regarding the lack of relevant guidance for the audit staff, on September 20, 2011, Chairman Horton along with other Board Members recommended that we work with the SUTD to establish guidelines for publication in the AM. Following that recommendation, we exchanged numerous communications with the SUTD, and eventually met with representatives of the SUTD and Legal Department on April 10, 2012, to address some final changes to the proposed guidelines. On May 11, 2012, Mr. Robert Wilke of the SUTD sent us a copy of the attached "Standard of Proof, Recommendation for Audit Manual Language," (first proposed guidelines) indicating that the Legal Department had reviewed the language without making any edits, and that the guidelines would be posted to the BOE website following our approval. We provided our approval on the same day.

On January 23, 2013, the current proposed guidelines were published on the BOE website. The guidelines currently proposed differ significantly from the first proposed guidelines agreed to by the SUTD and Legal Department. We believe the current proposed guidelines omit useful and accurate guidance. Thus, many of the suggestions below stem from

the first proposed guidelines, and all of the suggestions are intended to clarify the meaning and application of the preponderance standard.

Suggestion 1: *When the Preponderance of Evidence Standard Applies*

Paragraph one of the current proposed guidelines states:

“In cases where there is *conflicting evidence* and civil tax fraud is not involved, the BOE applies the preponderance of evidence standard of proof.” (Emphasis added.)

The preponderance standard applies generally to *all* civil cases where fraud is not involved, irrespective of whether or not *conflicting evidence* exists. (Evid. Code § 115.) In other words, the preponderance standard applies even when all of the evidence is consistent. The guidelines should be changed in this respect to conform to established California law.

Suggestion 2: *Communications between the Audit Staff and Taxpayers*

During the drafting process, it was universally agreed that open communications between the audit staff and taxpayers can help decrease unwarranted audit disputes. Therefore, we recommend reinstating the following sentence that was included in the first proposed guidelines:

“In performing an audit, the auditor should communicate with taxpayers and their authorized representatives to the fullest extent possible in an effort to establish facts which are relevant for sales and use tax audit purposes.”

Suggestion 3: *“Preponderance” defined*

The proposed definition for “preponderance of evidence,” although different from that in the first proposed guidelines, is more closely aligned with the enclosed definition provided in Chapter 7 of the BOE’s Property Tax Assessment Appeals Manual. We agree that consistency in the administration of tax programs among different BOE Departments is a worthwhile pursuit. The proposed SUTD guidelines, however, fail to address both standards of proof that are applicable to civil sales and use tax matters: the preponderance standard, *and* the clear and convincing standard.

An understanding of both standards will provide the audit staff with a better understanding of what each standard means. Providing guidance on both standards will also bring the AM guidelines in closer conformity to the Assessment Appeals Manual, thereby increasing consistency among the Departments. We therefore suggest that the clarifying language regarding the clear and convincing standard contained in the first proposed guidelines be reinstated, or, the applicable language provided in Chapter 7 of the Assessment Appeals Manual be added. Either option will help the audit staff to better understand and apply both standards.

Suggestion 4: “Evidence” defined

“Evidence” is defined by Evidence Code section 140 as: “testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact.”

We believe guidelines that address the preponderance of *evidence* should be clarified by providing California’s legal definition of “evidence.” For the same reason, and pursuant to Evidence Code section 600, the AM guidelines should clarify that legal presumptions are *not* evidence.

Suggestion 5: Audit Comments

In an effort to increase communications between the audit staff and taxpayers, and to help cultivate a more analytical thought process toward resolving factual issues, the first proposed guidelines contained specific language addressing the requirement to make comments regarding the evidence relied upon to support a stated conclusion. The current proposed guidelines simply reference AM sections 0304.00 and 0305.00 regarding comments. We believe the language contained in the first proposed guidelines should be reinstated for at least two reasons.

First, it was universally agreed that increased communications between the audit staff and taxpayers will help reduce disputes. A reduction in disputes will reduce the number of contested audits which will save time and money for everyone involved. Second, the referenced AM sections, 0304.00 and 0305.00, do not directly address comments regarding conclusions reached from applying the preponderance of evidence standard. We believe this stems in part from the absence of any preponderance of evidence guidelines at the time sections 0304.00 and 0305.00 were drafted. Thus, we recommend reinstating the language from the first proposed guidelines which specifically require audit comments to be made that describe the evidence relied upon to reach a conclusion.

Suggestion 6: Objectivity and Impartiality

The audit staff should assign no preference to evidence which supports the application of tax over similar evidence which weighs against the application of tax, unless there is a reasonable basis for considering it to be more persuasive. Such language was included in the first proposed guidelines, but it is now excluded for unknown reasons. Because the language helps to clarify what it means to be objective and impartial, a stated and worthy goal of the BOE, we believe it should be reinstated.

Suggestion 7: The “Note”

The current guidelines contain the following unprecedented “Note:”

Proposal to add AM section 0101.22 – Standard of Proof

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“This section clarifies existing law and does not signal a change in law or BOE policy. Staff should continue to apply these policies and procedures in conducting sales and use tax audits.”

There is no known current SUTD written policy that addresses the preponderance of evidence standard. The most probable interpretation of the above “Note,” therefore, would lead to a conclusion that “current policy” should continue to be adhered to. Because there is *no current* SUTD policy, such a suggestion could be misleading to the audit staff. For that reason, we suggest that the “Note” be deleted. Alternatively, we recommend the following “Note:”

This section clarifies existing law, and does not signal a change in the law. Staff should apply these policies and procedures in conducting sales and use tax audits.

We thank you for your careful consideration to the above suggestions. Please do not hesitate to contact us should you have any questions or comments.

Sincerely,



Jesse W. McClellan, Esq
Principal

Enclosures

cc: (all with enclosures)
Honorable Jerome E. Horton, Chairman, Forth District
Honorable Michelle Steel, Vice Chair, Third District
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable Betty T. Yee, Member, First District (MIC 71)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel
Mr. Todd Gilman, Taxpayers Advocate, (MIC 70)

Standard of Proof
Recommendation for Audit Manual Language

Pursuant to Revenue and Taxation Code section 6091, it is presumed that all gross receipts are subject to tax until the contrary is established. The presumption established under section 6091 is rebuttable, meaning that evidence may be provided which establishes that gross receipts are not subject to tax. The burden is placed upon taxpayers to establish facts by a preponderance of the evidence which demonstrates that tax is not applicable. In performing an audit, the auditor should communicate with taxpayers and their authorized representatives to the fullest extent possible in an effort to establish facts which are relevant for sales and use tax audit purposes.

The preponderance of the evidence standard is met when the evidence establishes that something is more likely to be true than not. The preponderance of the evidence standard does not require that the existence or nonexistence of a fact be proven by clear or convincing evidence or beyond a reasonable doubt; rather, it simply requires proof that the existence or nonexistence of a fact is more probable than not. The preponderance of the evidence standard should be applied in all cases, except for cases involving civil tax fraud. (See AM 0509.30.)

Evidence means testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact. Presumptions are not evidence.

Pursuant to Revenue and Taxation Code sections 7053 and 7054, it is the responsibility of the taxpayer to maintain and make available for examination all records necessary to determine the correct tax liability. If a taxpayer is not able to provide any evidence to demonstrate that a transaction (or a set of transactions) is not taxable, the presumption that tax applies is controlling. However, where a taxpayer is able to produce credible evidence regarding facts related to a particular transaction (or a set of transactions), the auditor should focus his or her review on the available evidence in establishing whether it is more likely to be true than not true that the transaction is not subject to tax. Credible evidence is generally considered to be evidence that is trustworthy. For transactions determined to be taxable by the auditor, the auditor must make detailed comments in the audit workpapers describing the evidence reviewed and his or her conclusions. If the auditor has a reasonable basis to believe that certain evidence is not credible, the auditor must also make detailed comments in the audit work papers in support of his or her conclusion in that respect. The failure to include such comments does not deem the evidence credible and has no evidentiary impact. However, the auditor may later be required to support his or her conclusions.

In all instances, the auditor must view all evidence in an objective and impartial manner. There should be no preference assigned to evidence supporting the application of tax over similar evidence which weighs against the application of tax, unless the auditor has a reasonable basis for considering it to be more persuasive. As previously noted, if an auditor has a reasonable basis to believe that certain evidence presented by a taxpayer or third party is unreliable, the auditor must make comments in the audit work papers detailing why the particular evidence was considered by the auditor to be unreliable.

BURDEN OF PROOF

Evidence Code section 115 defines *burden of proof* as "the obligation of a party to establish by evidence a requisite degree of belief concerning a fact in the mind of the trier of fact or the court." The party with the burden of proof is required to establish the existence or nonexistence of a fact by producing evidence that satisfies a required standard.

PREPONDERANCE OF EVIDENCE STANDARD

Unless otherwise provided by law, the required standard of proof in California is proof by a preponderance of the evidence.¹⁸⁸ This standard also generally applies to assessment appeal proceedings.¹⁸⁹ Thus, with respect to the assessor's presumption of correctness and its exceptions, the party with the burden must prove his or her case by a preponderance of the evidence.¹⁹⁰ A *preponderance of evidence* is usually defined "in terms of probability of truth" and as evidence which, when weighed against evidence offered in opposition to it, "has more convincing force and the greater probability of truth."¹⁹¹

CLEAR AND CONVINCING EVIDENCE STANDARD

There are certain legal presumptions applicable in property tax assessment matters in which the required standard of proof is that of *clear and convincing* proof. The clear and convincing standard is a higher standard than preponderance of the evidence and has been held to require evidence "so clear as to leave no substantial doubt."¹⁹² In other words, a preponderance calls for probability while "clear and convincing proof demands a high probability."¹⁹³

Examples of situations in property taxation where the clear and convincing standard apply are:

- i Evidence that a clerical or other error occurred that requires correction more than four years after the year of the enrollment.
- i Proof that an electronic transmittal of a tax payment was made on a specific date and time.

¹⁸⁸ Evidence Code section 115.

¹⁸⁹ Rule 324, subsection (a).

¹⁹⁰ Rule 321.

¹⁹¹ 1 Witkin, *Evidence* (3d ed. 1986) § 157, p.135.

¹⁹² *In re Jost* (1953) 117 Cal.App.2d 379.

¹⁹³ 1 Witkin, *Evidence* (3d ed. 1986) § 160, p.137.

STANDARD OF PROOF

0101.22

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For transactions determined to be taxable by the auditor, the auditor must make detailed comments in the audit workpapers describing the evidence reviewed and his or her conclusions. If the auditor has a reasonable basis to believe that certain evidence is not credible, the auditor must also make detailed comments in the audit work papers in support of his or her conclusion in that respect. The failure to include such comments does not deem the evidence credible and has no evidentiary impact. However, the auditor may later be required to support his or her conclusions. Staff should follow the applicable guidelines set forth in Audit Manual sections 0304.00, *Verification Comments*, and 0305.00, *Miscellaneous Comments and Notes*, in documenting its review of the transactions.

**Revisions to Initial Proposal Shown in Strikethrough/Underline Text
For Illustrative Purposes Only**

**Exhibit 3
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~~*Note: This section clarifies existing law and does not signal a change in law or BOE policy. Staff should continue to apply these policies and procedures in conducting sales and use tax audits.*~~