

**Final Statement of Reasons for
Proposed Adoption of California Code of Regulations,
Title 18, Section 1698.5, Audit Procedures**

Update of Information in the Initial Statement of Reasons

The factual basis, specific purpose, and necessity for the proposed adoption of the original text of California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*, are the same as provided in the Initial Statement of Reasons.

However, during the March 23, 2010, public hearing,¹ the Board made sufficiently related changes to the original text of proposed Regulation 1698.5 after considering a memorandum from the Board's Chief Counsel dated March 10, 2010.² This memorandum was identified and made available to the public as part of footnote 2 to the fifteen day letter dated April 9, 2010, which describes the sufficiently related changes in detail.³ The Board subsequently adopted the text of proposed Regulation 1698.5 with the sufficiently related changes at a public meeting on May 26, 2010.⁴

The Board deleted the phrase "which is used to confirm the start of an audit or establish contact with the taxpayer" from subdivision (a)(6) of the original text of proposed Regulation 1698.5; added a new subdivision (a)(2) to the original text of proposed Regulation 1698.5 to define the term "audit engagement letter" for purposes of the entire regulation; and renumbered the other paragraphs in subdivision (a) accordingly. The specific purposes for these sufficiently related changes are to clarify the definition of Information/Document Request and create a separate definition for "Audit Engagement Letter." The Board determined that these changes are necessary in order to help taxpayers identify and distinguish the two different types of correspondence and avoid potential confusion.

The Board changed the definitions for "Information/Document Request" and "Audit Findings Presentation Sheet" in subdivision (a) of the original text of proposed Regulation 1698.5. The specific purposes for these sufficiently related changes are to clarify that these documents are merely audit correspondence used to request information and documents from taxpayers and present audit findings to taxpayers, respectively; and further clarify that the Board is not trying to incorporate the correspondence or any additional regulatory requirements set

¹ The audio and video from the March 23, 2010, public hearing is available at www.visualwebcaster.com/event.asp?id=65371.

² The March 10, 2010, memorandum from the Board's Chief Counsel is available at www.boe.ca.gov/meetings/pdf/F1_032310.pdf.

³ The fifteen day letter is available at www.boe.ca.gov/meetings/pdf/Regulation_1698_5_15_day.pdf.

⁴ The audio and video from the May 26, 2010, meeting is available at www.visualwebcaster.com/event.asp?id=65393.

forth therein into Regulation 1698.5 by reference pursuant to California Code of Regulations, title 1, section 20. The Board determined that these changes are necessary to prevent the text of Regulation 1698.5 from creating an inference that these two types of correspondence are forms that have been incorporated into the regulation by reference pursuant to California Code of Regulations, title 1, section 20, or the inference that these two types of correspondence impose additional regulatory requirements on taxpayers.

The Board deleted the phrase “and provide adequate resources to do so” from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B). The specific purpose for this sufficiently related change is to clarify that taxpayers are not legally required to devote adequate resources to their audits. The Board determined that this change is necessary because the Board does not have statutory authority to require taxpayers to devote adequate resources to their audits.

The Board also changed the language in the original text of proposed Regulation 1698.5, subdivision (b)(5)(C) to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by any applicable law, not just a “federal” law, from requiring that taxpayers do so. The specific purpose for these sufficiently related changes is to clarify that Board staff is prohibited from requiring that taxpayers provide documents when the Board is prohibited from requiring the production of such documents under any applicable law, including both state and federal law. The Board determined that these changes are necessary to ensure that Board staff complies with all applicable laws.

In addition, the Board discussed the necessity for proposed Regulation 1698.5 during the March 23, 2010, public hearing and the Board Chair indicated that the regulation is necessary to clearly establish taxpayers’ and Board staff’s responsibilities and duties during the audit process in order to ensure that Board staff completes audits in a timely and efficient manner with due regard to each taxpayer’s rights, and to help taxpayers better understand and avoid confusion regarding the Board’s audit process, as explained in the fifteen day letter dated April 9, 2010.

Furthermore, the Board notes that proposed Regulation 1698.5 is substantially similar to Regulation 19032, *Audit Procedures*, which was adopted by the Franchise Tax Board in 2003. Regulation 19032 has the same general purpose as proposed Regulation 1698.5, to prescribe procedures for conducting tax audits. And, proposed Regulation 1698.5 is just as necessary for the administration and enforcement of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), as Regulation 19032 is necessary for the administration and enforcement of the franchise and income tax laws.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting Regulation 1698.5

with the sufficiently related changes 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 original public comment period, or was not identified and made available for public review and comment in the fifteen day letter dated April 9, 2010.

The Board did not reject any reasonable alternatives to the original proposed text of Regulation 1698.5 or any alternatives that would lessen the adverse economic impact on small businesses. No alternative language was presented to the Board for consideration other than the grammatical and sufficiently related changes recommended by Board staff in the memorandum from the Board's Chief Counsel dated March 10, 2010, and discussed by Board staff during the March 23, 2010, public hearing.

The Board has determined that the adoption of proposed Regulation 1698.5 will not have a significant adverse economic impact on business.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts.

Response to Public Comment

On March 23, 2010, the Board held a public hearing on the proposed adoption of Regulation 1698.5. No interested parties appeared at the public hearing and no written comments were received from interested parties. During the public meeting on May 26, 2010, the Board adopted proposed Regulation 1698.5 with the sufficiently related changes described in the fifteen day letter dated April 9, 2010. No interested parties appeared at the public meeting to comment upon the proposed adoption of Regulation 1698.5 with the sufficiently related changes and no written comments were received from interested parties regarding the proposed adoption of Regulation 1698.5 with the sufficiently related changes.

Alternatives Considered

By its motion, the Board determined that no alternative to proposed Regulation 1698.5 would be more effective in carrying out the purposes for which the regulation is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

No Federal Mandate

The adoption of Regulation 1698.5 is not mandated by federal statutes or regulations.