



STATE BOARD OF EQUALIZATION

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Executive Director

November 23, 2016

VIA INTERNET

Dear Interested Party:

The Audit Manual (AM) is a guide for the Board of Equalization (BOE) staff in administering tax and fee programs. It is available to the public and can be accessed from the BOE web page at <http://www.boe.ca.gov/sutax/staxmanuals.htm>.

The Business Tax and Fee Department (BTFD) is proposing to revise the following AM Chapters to incorporate current policies and procedures:

- Chapter 2, *Preparation of Field Audit Reports*
- Chapter 4, *General Audit Procedures*
- Chapter 5, *Penalties*
- Chapter 9, *Grocers*
- Chapter 14, *Appeals Procedures*

The revision material is provided on the following pages for the convenience of interested parties who may wish to submit comments or suggestions. Please feel free to publish this information on your website or otherwise distribute it to your association/members.

If you have any comments or suggestions related to the proposed AM revisions, you may contact the BOE at AM.RevisionSuggestions@boe.ca.gov. Your comments or suggestions must be received by BOE no later than **January 23, 2017**, in order to be considered by staff. Thank you for your consideration.

Sincerely,

Chief, Tax Policy Division
Business Tax and Fee Department

Audit Manual Chapter 2 Preparation of Field Audit Reports

FORM BOE—414—A, PAGE 1 – ANALYSIS OF MEASURE OF TAX BY CLASS OF TRANSACTION 0204.00

GENERAL

0204.03

The *Analysis of Measure of Tax by Class of Transaction* is detailed on Form BOE-414-A, page 2 (see Exhibit 1, page 2). The non-compliance code provides a clear and concise description of each class of transaction. ~~To see the table of non-compliance codes, click the IRIS TB drop-down menu and select “Non-Compliance Codes.”~~ Different classes of transactions, where separately identified in the audit working papers, should not be lumped together under one category even though consolidated on the “Taxable Measure,” Schedule 12 (i.e., self-consumed merchandise, sales of furniture and equipment, etc., should not be lumped together with an understatement of taxable sales based on application of markup).

Keeping the description of each class of transactions separate is vital because the system-generated copy of this report is sent to the taxpayer, which serves as the summary of the audit findings. Frequently, taxpayers file petitions for redetermination because the taxpayer is unable to understand or reconcile the “Analysis of Measure of Tax” with the information furnished by the auditor. Many of these petitions can be avoided by keeping the descriptions of each class of transactions separate and by providing clearer, more specific and precise descriptions.

The information on Form BOE-414-A, page 2 is directly imported from the Start21 “Juris Grid Worksheet.” When the audit results are ready to be uploaded into IRIS, auditors select the “IRIS TB” menu on the “BOE Auditing” tab and click the “Insert Juris Grid Worksheet” from the dropdown menu. A Juris Grid Worksheet should not be inserted into an audit until the audit process is completed. The Juris Grid Worksheet is used to specify audit errors (i.e., items of non-compliance), provide an “Error Description” used on Form BOE-414-A, page 2, and note which taxes apply to each error. This process prepares the audit for upload into IRIS and the uploaded information in IRIS is used to prepare the *Report of Field Audit* sent to the taxpayer.

When completing the Juris Grid Worksheet, auditors enter:

- A sequential “Item Code” (1, 2, 3...n) for each audit error,
- A non-compliance error code (NC Code) based on the table of Non-Compliance Codes,
- A schedule reference to indicate where the error came from, and
- A sufficient but concise explanation for each adjustment listed (see AM section 0204.09). The short description from the table of Non-Compliance Codes should *not* be used for this purpose.

Example:

R C	A	B	C	D	E	F
ITEM CODE				1	2	3
NC CODE				0403	0601	0201
REF				< 12 A >	< 12 B >	< 12 C >
REF				DISALLOWED CLAIMED REALES BASED ON STATISTICAL SAMPLING	DISALLOWED CLAIMED LABOR EXEMPTION BASED ON ACTUAL EXAMINATION	UNREPORTED EX-TAX PURCHASES OF SUPPLIES BASED ON ACTUAL EXAMINATION

The auditor should give the taxpayer sufficient information to reconcile the summary of audit findings appearing under the “Analysis of Measure of Tax” with the taxpayer’s records. This information should be in the form of copies of audit working papers, which will include all lead schedules necessary to reconcile with Form BOE-414-A. In some cases, a discussion of the results of audit findings may be sufficient, particularly when the audit is not too complex and only one or two classes of transactions may be involved. Even in these instances, however, a condensed summary of the audit findings should be included and would be appropriate, if for no other reason than to refresh the taxpayer’s memory concerning the “Report of Field Audit.”

CLASSIFICATION OF TRANSACTIONS

0204.09

The auditor will provide a sufficient but concise explanation of the detailed adjustments in numeric order on the ~~form~~ Juris Grid Worksheet (see AM section 0204.03). Analysis of the differences for all taxes should be similar in form as the following example:

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RECOMMENDATIONS REQUIRING ADMINISTRATOR’S APPROVAL

0204.14

Whenever a fraud or intent to evade penalty or jeopardy determination ~~(AM section 0204.15)~~ is recommended, a memorandum is required from the ~~District~~ Administrator or someone acting on his or her behalf. For fraud or intent to evade penalties involving sales and use tax, the memorandum is sent to the Chief, Headquarters Operations Division ~~for fraud or intent to evade penalties (see AM section 0509.75 and AM section 0213.12) or~~. For jeopardy determinations involving sales and use tax, the memorandum is sent to the Chief, Tax Policy Division (TPD), ~~for jeopardy determinations (see AM section 0204.15)~~. For fraud or intent to evade penalties or jeopardy determinations involving special taxes and fees programs, the memorandum is sent to the Chief, Audit and Carrier Division. Copies of the respective memorandum will be sent to the ~~Chief~~ Deputy Director, Field Operations ~~Division~~ Department or the Deputy Director, Business Tax and Fee Department. (See AM section 0213.12 and AM Chapter 5, section 0509.75 for detailed information).

~~The memorandum will include all of the facts and circumstances that support the recommendations. The administrator or acting administrator must sign the memorandum. After execution of the memorandum by the administrator, attach the completed memorandum to the audit report and forward for review. Approval will be obtained after the review process is completed (AM section 0507.75).~~

JEOPARDY DETERMINATIONS

0204.15

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A recommendation for a jeopardy determination should be well documented and fully supported and include all of the facts and circumstances that support the recommendation. ~~(see AM section 0204.14).~~ The recommendation will set forth the specific evidence that indicates a jeopardy determination is warranted. To request a jeopardy determination, staff must prepare a memorandum that includes the following: and will include:

1. The taxpayer's name and address.
2. The source and status of the underlying liability.
3. The taxpayer's overall financial condition, including a list of all known assets and liabilities.
4. The amount of equity available for a lien or levy.
5. The taxpayer's present and future income potential, including the taxpayer's ability to earn wages or pay the liability if there is no jeopardy determination.
6. Documentary evidence to support a jeopardy determination.
- ~~1-7.~~ Information as to the county or counties where ~~liens~~ a Notice of State Tax Lien ~~are~~ is to be filed.
- ~~2-8.~~ Whether or not a lien is to be recorded with the Secretary of State.
- ~~3-9.~~ Whether or not a warrant is ~~required at the time of issuance~~ requested. This must include the name of the person to whom ~~it~~ the warrant is to be directed ~~sent~~, the asset(s) ~~or assets~~ to be levied upon, and the amount of advanced fees that may be required.

Specific Special Taxes Programs

Determinations issued to "Unlicensed Persons" under the Cigarette and Tobacco Products Tax Law, the Diesel Fuel Tax Law, or the Motor Vehicle Fuel Tax Law are required to be issued as a jeopardy determination; therefore, the memo requesting approval does not need to include information on the taxpayer's overall financial condition and their present and future income potential.

A list, *Resources for Jeopardy Determination Analysis*, is available on eBOE to assist staff in locating assets, providing support when estimating the amount of equity available in real property, disclosing the priority of liens and other encumbrances, and showing whether a taxpayer is becoming insolvent.

For sales and use tax, the original request for a jeopardy determination is routed to the Tax Policy Division (TPD) Chief, with a copy sent to the Special Operations Branch (SOB), Legal Department. If the request for a jeopardy determination is approved, the TPD Chief will notify SOB to proceed. For the Investigations Division (ID), the original request for a jeopardy determination is routed to the Investigation and Special

Operations Division (ISOD) chief. If the request for a jeopardy determination is approved, the ISOD chief will notify SOB to proceed. Audit Determination and Refund Section (ADRS) is responsible for billing jeopardy determinations. For special taxes and fees accounts, the original request for a jeopardy determination is routed to the Chief, Audit and Carrier Division, with a copy sent to SOB. If the request for a jeopardy determination is approved, the Chief, Audit and Carrier Division, will notify SOB to proceed. Appeals and Data Analysis Branch (ADAB) is responsible for billing jeopardy determinations on special tax and fee accounts.

Include ~~the a copy of the completed~~ memorandum in the *Memos and Miscellaneous Documents* subfolder of the audit case folder (See AM section 0302.50). ~~with the audit report or field billing order.~~ Add a notation, “Jeopardy Determination — see memo ~~attached,~~” on page 3 of ~~Form the~~ BOE-414-A under the “Special Instructions” caption (see AM section 0204.12).

For more information, see CPPM sections 753.000, *Warrants and Levies*, and 757.000, *Notices of State Tax Liens, Abstracts of Judgment and Liens*.

PENALTY COMMENTS

0206.45

The auditor must enter a penalty comment in the “General Audit Comments” of either Form BOE-414-A or Form BOE-414-B under the heading “Penalty” when a penalty is recommended or when the tax liability is \$2,500 or more and no penalty is recommended. Comments should be clear and concise, explaining the rationale for the auditor’s recommendation (penalty recommended and no penalty recommended). Canned comments, such as “Negligence not noted” or “No penalty recommended,” should be avoided.

For tax liabilities over \$25,000, the auditor’s supervisor must review and approve the penalty comment. For tax liabilities over \$50,000, the Office Making Audit (OMA) Principal Auditor must review and approve the penalty comment subsequent to approval by the auditor’s supervisor. Supervisors and Principal Auditors will be deemed to have approved penalty comments when they indicate their approval of the audit as a whole on the digital audit email approval chain. (See AM section 0213.06) ~~Supervisor’s comments are required for penalty comments when the tax liability is greater than \$25,000. For a tax liability greater than \$50,000, District Principal Auditor’s comments are required.~~

See AM Chapter 5, *Penalties*, for general guidelines and procedures on penalties.

AUDIT MANUAL CHAPTER 4, GENERAL AUDIT PROCEDURES

AUDIT OF ELECTRONIC BENEFIT TRANSFER (EBT) CARD PURCHASES 0419.60 GENERAL

The Electronic Benefit Transfer (EBT) program is the system used for the delivery, redemption, and reconciliation of two types of public assistance benefits in California:

- 1) Those issued by the United States Government (USG), specifically, CalFresh benefits (formerly, ~~the federal~~ food stamps ~~program~~, see AM section 0904.30); and
- 2) The ~~s~~State-authorized cash aid benefits (state welfare benefits programs, such as CalWorks and General Assistance).

Recipients of public assistance access their issued benefits with an EBT card which is similar to a “debit card.” Paper food stamps have been replaced by the EBT card. The EBT program is administered ~~on behalf of the USG and the state~~ by ~~both~~ the California Department of Social Services and the state’s counties.

EBT PROGRAM

Counties are responsible for administering certain federal and state public assistance benefits programs. The EBT program allows counties to provide cash benefits to recipients via EBT cards. CalFresh and state-authorized cash aid benefit recipients can use their EBT card at point-of-sale terminals at participating retailers that are authorized to process these transactions. At the time of a purchase with the EBT card, the recipient must ~~selects~~ either their federal ~~CalFresh~~ account or the state-authorized cash aid benefit account from which payment will be made.

PRODUCTS PURCHASED WITH AN EBT CARD – ~~FEDERAL~~ CALFRESH ACCOUNT BENEFITS

Products which are *eligible* to be purchased with ~~an EBT card federal~~ CalFresh ~~account~~ benefits and are so purchased are not subject to the sales and use tax (Regulation 1602.5(c)). Products which are normally taxable, but are exempt when purchased with ~~an EBT card federal~~ CalFresh ~~account~~ benefits include among other things: non-alcoholic carbonated beverages, food coloring extract, ~~and~~ ice, etc. This deduction will normally be found when auditing grocery stores; however, it could be claimed by mini-marts, liquor stores, drugstores with food sections, and other retailers which are eligible to accept an EBT card.

Taxpayers may claim the deduction on an actual basis, as an amount equal to 2% of the ~~EBT card federal~~ CalFresh ~~account~~ benefit purchases made during the period of the return, or as a percentage computed by the taxpayer in accordance with Regulation 1602.5(c).

As this deduction will usually be rather small, any large claimed deductions will warrant careful examination.

RESTAURANT MEALS PROGRAM

General

The Restaurant Meals Program (RMP) is an optional county-administered program that allows *eligible* CalFresh recipients to use their ~~federal~~-CalFresh benefits via their EBT card to purchase hot prepared food products at participating low-cost restaurants in certain counties within the state. The RMP enables elderly (over 60 years of age), disabled and homeless individuals and their spouses receiving CalFresh benefits to use their EBT card to purchase meals from participating restaurants. For all other CalFresh recipients, the federal rules preventing the purchase of prepared food still apply. The RMP does *not* apply when recipients use state-issued cash aid benefits to pay for hot prepared food products.

Counties offering the RMP are responsible for certifying the eligibility of recipients of CalFresh benefits and for informing the RMP recipients of names and addresses of participating restaurants. The participating counties determine the recipients' eligibility to the program and code their EBT card so that it may be accepted as payment for meals at participating restaurants. The EBT card has to be presented prior to ordering a meal from an approved restaurant so the restaurant can verify the eligibility of the RMP recipient.

The following counties participate in the RMP as of 2016~~5~~:

- Alameda,
- Los Angeles,
- San Francisco,
- Sacramento,
- San Diego
- Santa Clara,
- Santa Cruz, and
- San Luis Obispo.

New counties join each year; the listing of participating counties is available at <http://www.cdss.ca.gov/foodstamps/PG3665.htm>.

Pursuant to the terms of the RMP, participating restaurants cannot charge sales tax or any other fees to individuals using their ~~federal~~-CalFresh benefits to purchase hot prepared food products. However, the terms of the RMP do not prohibit participating restaurants from charging sales tax on sales of hot prepared food products normally subject to tax, when the sales are made to individuals using state-issued cash aid benefits to purchase the hot prepared food products, and not ~~federal~~-CalFresh benefits.

Ultimately, whether tax applies to the sales of retailers participating under the terms of the RMP depends in part on whether the payment received is authorized pursuant to the ~~federal~~-CalFresh benefits program, ~~and thus, a sale to the United States Government (USG);~~ or the payment received is authorized pursuant to a state-issued cash aid program, which represents a sale to the State of California.

CalFresh RMP – Sales to the United States Government (USG)

The sale of hot prepared food products to CalFresh benefits recipients eligible for the RMP who uses an EBT card to authorize payment for the hot prepared food products may qualify as a sale to the United States Government (USG) provided the following conditions are met. To qualify as a sale to the USG:

1. The CalFresh benefits recipient must be an authorized EBT cardholder,
2. Both the CalFresh recipient and the retailer must be eligible to participate in the RMP, and
3. The CalFresh recipient must select their ~~ir federal~~-CalFresh ~~account~~ benefits to authorize payment for the sale of the hot prepared food products.

Provided all of these conditions are satisfied, the sale of hot prepared food products qualifies as a sale to the USG, and tax does not apply to the sale. To support a claim that tax does not apply to the sale, the retailer is required to obtain evidence of direct payment by the USG. Evidence of direct payment by the USG includes sales receipts which indicate either “Supplemental Nutrition Assistance Program” or “SNAP” or bank statements listing electronic funds transfers to the taxpayer as either “Supplemental Nutrition Assistance Program” or “SNAP.”

State-issued Cash Aid Benefits Program (CalWorks, Public Assistance, etc.)

When a qualifying individual selects the state-issued cash aid benefits account to authorize payment for the sale of hot prepared food products, a sale to the state occurs. There are no general exemptions from tax to sales of tangible personal property to the state. Tax applies to sales of hot prepared food products to the state as the sale of tangible personal property generally, regardless of whether the retailer is eligible to participate in the RMP.

In some cases, qualifying individuals using their public assistance benefits at RMP participating restaurants may combine their ~~federal~~-CalFresh benefits and state-issued cash aid benefits on their EBT card to cover the purchase of hot prepared food products. When payment is made partly with ~~federal~~-CalFresh benefits, and partly with state-issued cash aid, only the portion of the gross receipts that represents a sale to the USG (~~federal~~-CalFresh benefits) is subject to an exemption from tax. The remaining amount represents a sale to the state and as such is subject to tax. The retailer is required to identify in its records the taxable and nontaxable portions of its sales and maintain written evidence documents showing direct payment by the USG.

AUDIT MANUAL CHAPTER 5, PENALTIES

EFFECT OF LEGAL HOLIDAYS AND WEEKENDS ON DUE DATES

0502.35

Whenever the due date falls on a Saturday, Sunday, or legal holiday, the filing of returns and the payment of taxes may be made on the following business day without penalty. The following is a list of legal holidays as set forth in the Government Code:

New Year's Day	January 1
Martin Luther King, Jr. Day	3rd Monday in January
Lincoln's Birthday	February 12
President's Day	3rd Monday in February
Cesar Chavez Day	March 31
Memorial Day	Last Monday in May
Independence Day	July 4
Labor Day	1st Monday in September
Columbus Day	2nd Monday in October
Veterans Day	November 11
Thanksgiving Day	4th Thursday in November
Day after Thanksgiving	Friday after Thanksgiving
Christmas	December 25

If ~~one of the foregoing a listed~~ legal holidays falls on a Sunday, the holiday is observed on the following Monday ~~is a legal holiday~~. If Veterans Day falls on a Saturday, the preceding Friday is observed as a legal holiday.

PENALTY COMMENTS ON AUDIT REPORTS OR FIELD BILLING ORDERS

0506.35

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To promote consistency in the application of penalties and the writing of penalty comments, all comments must be reviewed by the auditor's supervisor. In addition, special procedures will be used for the following reviews:

- Audit tax deficiency over \$25,000 — Reviewed and approved by the auditor's supervisor.
- Audit tax deficiency over \$50,000 — Reviewed and approved by the ~~District~~ Office Making Audit (OMA) Principal Auditor subsequent to the review and approval by the auditor's supervisor.

~~This review and approval must be noted by the supervisor (and DPA if applicable) by commenting and signing directly below the auditor's penalty comment in the "General Audit Comments" section of Form BOE 414 A or Form BOE 414 B. This may be a handwritten comment or incorporated as the last line of the penalty comment (e.g., "Reviewed and approved. _____, Supervisor; _____, DPA.") See AM section 0206.45.~~
Supervisors and Principal Auditors will be deemed to have reviewed and approved penalty comments when they indicate their approval of the audit as a whole on the digital audit email approval chain (See AM section 0213.06). approval

APPROVAL OF EVASION PENALTIES

0509.75

When an audit recommends ~~the an~~ evasion penalty, a memorandum is required from the ~~District~~ Administrator to the Chief, Headquarters Operations Division for sales and use tax and the Chief, Audit and Carrier Division for special taxes and fees. Upon the approval of the ~~District~~ Administrator or someone acting on his or her behalf, and after the completion of ~~district~~ audit review, the memorandum along with the audit case folder report and working papers are sent electronically will be forwarded to the Chief, Headquarters Operations Division or Audit and Carrier Division for approval. See AM section 0213.12 for instructions on electronically submitting memorandums and audits recommending evasion penalties. This information is also available on the Headquarters Operations Division eBOE page under "Approve Fraud Penalty Requests". ~~with a~~ A copy of the respective memorandum is also sent to the ~~Chief~~ Deputy Director, Field Operations ~~Division~~ Department or the Deputy Director, Business Tax and Fee Department. ~~Equalization Districts 1 & 2 and Out of State District, or the Chief, Field Operations Division, Equalization Districts 3 & 4 and Centralized Collection Section.~~ *The taxpayer may not be furnished a copy of the memorandum until the Chief, Headquarters Operations Division, or the Chief, Audit and Carrier Division, has approved the evasion penalty.*

The memorandum must clearly state the evidence which supports the taxpayer's intent to evade the payment of tax and must identify the elements or indicators of fraud applicable to the specific case. Any confidential evidence that is not included in the audit working papers must be attached to the memorandum. The memorandum must explain why the evasion penalty is appropriate versus the negligence penalty, and how the taxpayer benefited from the evasion. It must not include lengthy comments or comments that are already part of the audit verification comments. If the quarterly reconciliation of the audited and reported amounts supports the recommendation of the evasion penalty, such information should be summarized and not be shown on a quarterly basis. If an audit includes related taxpayers, a separate memorandum must be prepared for each taxpayer for whom the auditor recommends an evasion penalty.

In addition, auditors should consider the following elements when preparing a memorandum recommending an evasion penalty:

- The memorandum:
 - Should stand alone and include all relevant information for the penalty recommendation. Attach any information, audit schedules, or other documentation (such as letters, emails, or statements) that are referenced in the memorandum.
 - Should include the phrase "clear and convincing evidence" when explaining the reason for the evasion penalty recommendation.
 - Must specifically describe the evidence staff believes is clear and convincing evidence of taxpayer's intent to evade the taxes due.
 - Should include a discussion of why the evasion penalty instead of the negligence penalty is appropriate.
 - Should include tables, reconciliations, charts, etc., that support the evasion penalty recommendation as these may provide good visual guides to the errors and discrepancies.

- Use the term "evade" or "intent to evade" rather than fraud, when possible.

Following are suggested headings and examples of relevant information to include in memorandums recommending an evasion penalty. These suggestions are meant to provide guidance and may be used as an instructional tool. Staff may modify the headings and add any additional information as needed.

Introduction (example of an opening paragraph):

We recommend application of the 25% penalty per RTC section 6485, for Taxpayer, during the period xx/xx/xx to yy/yy/yy. We believe the evidence described below establishes by clear and convincing evidence that the tax deficiency is the result of a deliberate intent to evade the payment of tax.

If multiple penalties are recommended, separately list all penalties and the applicable periods. If the penalties have specific requirements in addition to clear and convincing evidence of an intent to evade the tax, such as the 40% penalty, the opening paragraph should also address those requirements.

Business Operations

Summarize the business operations, hours of operations, and any other relevant information.

Audit Investigation

Summarize the taxpayer's recording and reporting method, types of books and records provided, the audit methodology, and the results of the audit investigation.

Describe the taxpayer's involvement in the business, for example, if the taxpayer was involved in the day to day business operations, placed orders, purchased inventory, paid vendors, recorded transactions, or prepared the sales and use tax returns, etc. Describe the taxpayer's knowledge of the law and/or reporting requirements; such as, the length of time the taxpayer has been in business, prior permits, prior audits (with or without similar errors), letters to and from the BOE, ACMS documentation of communications with the taxpayer, questionnaires or statements from the taxpayer or others involved with the business, such as employees, bookkeepers, and accountants, and BOE publications or other information previously provided to the taxpayer.

Evidence Supporting Fraud

The memorandum must clearly describe all the evidence from the audit investigation that supports the taxpayer's intent to evade the payment of tax (see AM section 0509.10 for the definition of fraud). The evidence should include any direct evidence of fraud and/or circumstantial evidence that indicates a deliberate attempt to evade the payment of tax. In most cases, it will be necessary to rely primarily on circumstantial evidence to show that taxpayer's failure to pay was a deliberate attempt to evade the payment of tax. Evidence that may establish that taxpayer's failure to follow the law was done with the intent to evade the tax may include, but is not limited to:

- Falsified records and/or more than one set of records.
- Substantial and pervasive underreporting.
- Failure to pay substantial tax reimbursement collected from customers.
- Improbable or inconsistent explanations for the underreporting.
- Misrepresentations or other efforts to conceal the correct tax liability.
- Use of multiple bank accounts to conceal income.
- Evidence of improper transfers of unreported tax reimbursement.

Any assertion of an intent to evade the tax must be supported by as many of the above indicators as possible. Any indicator of evasion must be documented to the extent possible. Findings of substantial discrepancies and proper charging of tax or tax reimbursement are generally *not*, in and of themselves, enough to establish an intent to evade. Other evidence of taxpayers' intent to evade the tax *must* be included in the memorandum.

Intent to evade must generally be established by evidence that the taxpayer knew that the taxes at issue were due and that the taxpayer's failure to pay was deliberate and for the purpose of evading the tax (as opposed to a lack of funds). Evidence that may be used to establish knowledge of the law includes, but is not limited to:

- Taxpayer's length of time in business.
- Taxpayer's prior operation of other, similar businesses as evidenced by prior permits held by the taxpayer.
- Prior audits, letters, or other written advice received from the BOE.
- Taxpayer's personal involvement in the day to day operation of the business, including but not limited to the preparation of returns.
- Accurate calculation of tax on taxable sales, including charging the correct amount of district taxes.
- Otherwise accurate recordkeeping of sales.
- Accurate reporting of sales on returns filed with other agencies, such as income tax returns.
- Prior statements by the taxpayer or other employees regarding knowledge of the applicable tax laws.
- Evidence of communications with accountants or bookkeepers regarding the correct reporting of taxable sales.

Always ask the taxpayer for an explanation of the errors/discrepancies that led to the recommendation of the evasion penalty and include the taxpayer's explanation in the memorandum. As explained above, an improbable or inconsistent explanation may be evidence of the taxpayer's intent to evade the tax. If the taxpayer has no explanation for the errors, document this in the memorandum as well.

The memorandum should always include an explanation of how the taxpayer benefited by evading the payment of tax. For example, by not reporting all recorded taxable sales, the taxpayer has benefited monetarily by retaining the tax collected from their customers. Or, by evading the payment of tax, the taxpayer was operating at a competitive advantage over others in the same business.

Include any tables, reconciliation, charts, etc., in the memorandum that support the penalty recommendation. Attach copies of all documents that are referenced in the memorandum. Documentation that may support an evasion penalty include audit schedules, copies of falsified records, prior audit reports, BOE letters or other publications providing specific advice, copies of previous permits and applications, evidence of improper transfers of unreported tax, and letters or notes between taxpayer and employees or agents.

If recommending RTC section 6597 40% penalty (tax reimbursement collected and not timely remitted), in addition to establishing, by clear and convincing evidence, taxpayer's intent to evade tax, staff should state and explain how all conditions listed in AM section 0509.65 for applying the 40% penalty are met. The inclusion of a table of quarterly tax collected and tax reported to illustrate that the conditions listed in AM section 0509.65 are met is recommended.

Summary and Recommendation

Summarize why the evasion penalty is recommended and include a discussion of why the imposition of the evasion penalty is appropriate instead of a negligence penalty. For example, prior business experience and/or otherwise accurate recordkeeping, combined with substantial, repeated, and unexplained error rates and/or understatements, improbable and/or inconsistent explanations, falsified records, etc., all are evidence of an attempt to evade that is not merely the result of negligence.

The following provides an example of a concluding paragraph:

The taxpayer was aware of the laws regarding the proper reporting of taxable sales as evidenced by his/her prior business experience, advice received in prior audits, and otherwise accurate recordkeeping of sales, including the correct calculation of tax on taxable sales. Despite this knowledge, the taxpayer had consistent and material underreporting of taxable sales throughout the reporting period. The taxpayer failed to report substantial amounts of tax reimbursement collected on taxable sales. In addition, the taxpayer was personally responsible for the preparation of the sales and use tax returns and provided inconsistent and improbable explanations for the underreporting. The foregoing is evidence that the taxpayer's underreporting cannot reasonably be concluded to have been an act of mere negligence. The foregoing establishes by clear and convincing evidence that taxpayer failed to report the taxes due with the intent to evade tax and therefore the conduct is not merely negligent, but fraudulent.

In those cases where criminal tax evasion is suspected and potential prosecution is contemplated, the case should be referred to the Investigations Division through the Chief Deputy Director, Field Operations Division Department or the Deputy Director, Business Tax and Fee Department, Equalization Districts 1 & 2 and Out of State District, or Chief, Field Operations Division, Equalization Districts 3 & 4 and Centralized Collection Section. Criminal prosecution comments should be made only on the copy to the appropriate Deputy Director. ~~Chief, Field Operations Division.~~

AUDIT MANUAL CHAPTER 9, GROCERS

MISCELLANEOUS OTHER SALES

0902.60

Rentals

Some grocery stores rent videotapes, video equipment, and carpet cleaners. Rentals of videotapes or videodiscs for private noncommercial use are subject to tax. Tax applies to such rentals even though tax was paid on the cost of the item either to the grocer's vendor or directly to the Board [of Equalization \(BOE\)](#).

ESTIMATES

0905.30

The following methods for reporting tax liability based on estimates are not recommended, but may be found in use by the taxpayer:

- Estimates based on tax reported in a prior period.
- Estimates based on a ratio of taxable sales to total sales in a prior period.
- Estimates based on the application of unsubstantiated markups or based on other methods that have not been approved by the ~~Board~~[BOE](#).

Auditors should use appropriate markup methods to verify if the taxpayer's estimate reasonably discloses the correct amount of tax due.

MODIFIED PURCHASE-RATIO METHOD

0907.00

~~BOARD REVIEW OF SPECIFIC PROCEDURE~~ ~~0907.15~~

~~Grocers contemplating use of a modified purchase ratio reporting method are urged to submit the proposed method to the Board for review and approval prior to use (see Section 0911.00).~~

COST PLUS MARKUP METHOD — TAXABLE MERCHANDISE

0908.00

~~BOARD REVIEW OF SPECIFIC PROCEDURE~~ ~~0908.15~~

~~Grocers contemplating use of the cost plus markup method of reporting are urged to submit a general outline of proposed markup procedures to the Board for review and approval prior to use of such procedures (see Section 0911.00).~~

~~BOARD APPROVAL OF SPECIFIC REPORTING PROCEDURES 0911.00~~

~~APPROVAL GUIDELINES 0911.05~~

~~As provided in Regulation 1602.5, grocers who are contemplating use of a *modified purchase ratio or cost plus markup* method of reporting are urged to notify the Board of such intentions and to submit the proposed procedures to the nearest Board office for review prior to use of such procedures. The review, approval, and agreement with the taxpayer on proposed procedures will normally be done at the district or branch office level subject to concurrence of the Tax Policy Manager. Proposed procedures must be consistent with Regulation 1602.5 and the following guidelines:~~

- ~~(a) The Board has agreed with the California Grocers Association to review proposed reporting procedures in advance of use, when requested to do so.~~
- ~~(b) All requests should be honored and sufficient time should be spent to insure that proposed reporting procedures are proper. Time spent in reviewing and approving such requests should be charged to Advisory Services Code 3208, except if verification and instruction are in conjunction with audit verification, in which case, the time should be charged to Direct Field Code 3103.~~
- ~~(c) A memo to the Tax Policy Manager on proposed reporting procedures must spell out in detail the agreement worked out with the taxpayer on procedures to be followed and the recommended period of authorization. A copy of this memo must be sent to the Chief of Field Operations, or the Collections and Third District Operations Manager.~~
- ~~(d) Authorizations for use of approved procedures generally should be issued to coincide with the ending period of the next audit plus one quarter. However, letters of authorization should not be issued for periods of less than two years. Therefore, if the next anticipated audit period ends in a period less than eighteen months from the date of the request, the authorization should be granted for three years plus the period to the end of the next scheduled audit plus one quarter. For example, if the last audit was through December 1996, and a request is received in July 1999, the authorization should be for the period ending March 31, 2003. On the other hand, if the last audit was through December 1997, the authorization should be through March 31, 2001.~~

~~The approval should be granted subject to the understanding that the procedures will be reexamined at the time of the next regularly scheduled audit, and the taxpayer will be required to make current tests as deemed necessary in order to obtain a new letter of authorization.~~

- ~~(e) Written authorization of approved procedures will be furnished to the taxpayer by the Tax Policy Manager only. Districts will not furnish written approval. This is to insure uniformity of practice and maintenance of a central record of all authorizations. It is therefore essential that districts furnish the Tax Policy Manager with complete information on proposed reporting procedures.~~
- ~~(f) Letters of authorization will not normally be furnished for reporting procedures other than modified purchase ratio or cost plus markup, as specifically provided for in Regulation 1602.5.~~

ELECTRONIC SCANNING SYSTEMS

0912.00

GENERAL

0912.05

Electronic scanning systems utilize electronic scanners and central computers to automatically compile and record taxable and nontaxable sales, sales tax, and related data from scanning of products imprinted with the Universal Product Code (UPC). ~~If a For grocers contemplates using~~ of scanning system results for sales tax reporting purposes, it is important to ensure that proper controls are maintained for monitoring and verifying the accuracy of the scanning results and tax returns. For example, the scanning programs relating to product identity, price, sales tax code, program changes and corrections, etc., must be retained for future examination by the ~~Board's BOE's~~ audit staff. Records which clearly show a segregation of taxable and nontaxable merchandise purchases would also provide grocers and the ~~Board BOE~~ with additional data from which the scanning accuracy may be monitored or verified.

* * * * *

~~**BOARD REVIEW OF SPECIFIC PROCEDURE**~~

~~**0912.15**~~

~~Grocers contemplating use of scanning system results for sales tax reporting purposes are required to notify the Board of such intentions and to submit a general outline of the proposed reporting method to the Board for review and approval prior to adoption of such method for reporting purposes. All requests from grocers to report using electronic scanner systems, will be referred to the appropriate district office for review. Once district staff has reviewed the grocer's reporting procedures to determine if they are in substantial compliance with the guidelines set forth in Section 0912.20, the District Administrator will submit a memo to the Tax Policy Manager, stating his/her recommendation with regard to the taxpayer's request. A copy of this memo must be sent to the Chief of Field Operations, or the Collections and Third District Operations Manager.~~

~~The Tax Policy Manager may:~~

- ~~3) Concur with the district recommendation, in which case, a reply will be sent to the taxpayer (with a copy to the district) indicating that the request was approved, subject to the agreed guidelines, or disapproved, and stating the reasons the request has not been approved.~~
- ~~4) Disagree with the district recommendation, in which case, a reply memo will be sent to the District Administrator indicating the nature of the disagreement and providing further instructions on how the district should proceed to assure a timely resolution of the grocer's request.~~

RECORD KEEPING REQUIREMENTS

0912.20

In addition to the normal books of account that ordinarily must be maintained by a prudent businessperson, the following records should also be developed and retained by all grocers ~~requesting to report~~ing by use of electronic scanners:

* * * * *

~~(d)~~ GENERAL OUTLINE OF REPORTS, RECORDS AND PROCEDURES 0912.25

~~Used~~ When rReporting wWith eElectronic sScanners, gGrocers ~~will be required to should maintain~~keep a general outline of their electronic scanner reporting methods for auditors to use as a means of verifying that proper controls are maintained to monitor the accuracy of the scanning results. The outline should address the following areas:

1. Type and form of records and reports generated.
2. A description of who is responsible for testing, maintaining and correcting the scanning system. Whether the retailer operates one store or a chain of stores, we need to know who has the authority to enter and/or alter information contained in the "Master List," with respect to price, product, codes, etc.
3. How does the scanner system account for purchases made with CalFresh benefits, manufacturers' coupons, bottle deposits, over rings, etc.?
4. If there are department(s) and/or stores handling sales, in whole or in part, in some manner other than with scanners, how are these sales accounted for in the records?

~~(e) Additional Requirement — For future audit purposes when it may become necessary to utilize traditional audit approaches, grocers will be required to agree to segregate a representative sample of taxable and nontaxable merchandise purchases, if requested (see Section 0912.10).~~

Audit Manual

Chapter 14

Appeals Procedures



~~Sales and Use Tax~~[Business Tax and Fee](#) Department

*California State
Board of Equalization*

This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda.

Please contact any ~~board~~[Board of Equalization](#) office if there are concerns regarding any section of this publication.

APPEALS PROCEDURES

1400.00

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TERMINOLOGY

1401.02

Taxpayer includes a fee-payer, claimant or petitioner, as applicable.

Department means the ~~Sales and Use Tax Department (SUTD)~~Business Tax and Fee Department (BTFD), the Field Operations Department (FOD), the Property Tax Department, the Administration Department, ~~the Property and Special Taxes Department (PSTD)~~, or the Legal Department's Investigations and Special Operations Division, as applicable.

Office means ~~SUTD's Centralized Collection Section or~~ district offices, or ~~PSTD's~~ Headquarters or field staff groups for special tax programs in the Special Taxes and Fees Division, or Property Tax Department's Timber Tax Section, or the Legal Department's Investigations and Special Operations Division, as applicable.

Petitions means ~~SUTD's BTFD's~~ Petitions Section or ~~PSTD's~~ Appeals and Data Analysis Branch, Property Tax Department's Timber Tax Section, or the Legal Department's Investigations and Special Operations Division, as applicable.

Refunds means ~~SUTD's BTFD's~~ Audit Determination and Refund Section or ~~PSTD's~~ Appeals and Data Analysis Branch, or Property Tax Department's Timber Tax Section, or the Legal Department's Investigations and Special Operations Division as applicable.

PETITIONED AUDIT DETERMINATIONS

1404.00

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APPEALS CONFERENCE

1404.06

Petitions or Refunds, as applicable, will contact the taxpayer to verify and update the taxpayer's contact information and inquire as to whether the taxpayer would prefer that the appeals conference be held at a specific ~~Board~~BOE office. Unless the taxpayer indicates another preference, the appeals conference will generally be held in the ~~Board~~BOE office that conducted the taxpayer's audit or recommended denial of the taxpayer's claim for refund. ~~The DPA and the investigating auditor or their designated representative(s) from that office should attend the appeals conference, especially for fraud cases.~~

Representation at Appeals Conferences

The following clarifies the role and responsibility of the Business Tax and Fee Department (BTFD), the Field Operations Department (FOD) and the Administration Department for providing representation at appeals conferences.

Conferences Involving Audit Appeals

The office making audit (OMA) is identified on the Appeals Maintain/Inquire Case Header (APL MH) screen. The appeals conference will generally be held at the OMA.

However, the appeals conference may be held in Headquarters or a different field office (“host office”) to accommodate the taxpayer and/or the taxpayer’s representative. In all instances, the OMA’s Principal Auditor, or his or her designee, will be the Department’s representative and should attend the appeals conference in person. Such representation is necessary as the Principal Auditor and/or the auditor are familiar with the case, including the specific reason(s) the tax was determined to be due. This is especially important for cases involving fraud or complex audit issues. The presence and experience of the Principal Auditor, or his or her designee, provides valuable support for the auditor, lends credibility to the Department’s position, and gives the Appeals Division conference holder an additional resource during the appeals conference. The appeals conference is intended to be an informal discussion of relevant facts and applicable law and the Principal Auditor, or his or her designee, should present all evidence and arguments concerning the disputed amounts.

Any exhibits, schedules or documentation which will be referenced during the appeals conference, which are not included in the appeals case file or in the electronic copy of the archived audit file should be provided to the conference holder **prior** to the conference. Similarly, prior to the conference, the conference holder should provide the OMA with any and all taxpayer exhibits, binders, schedules, etc., received by the Appeals Division or Board Proceedings Division which were not already copied to the OMA.

When it is not feasible for the OMA’s auditor and the Principal Auditor, or their designee, to be physically present at the appeals conference due to geographic distance, the auditor and the Principal Auditor will represent the Department by telephone and this should be communicated to the Board Proceedings Division and the conference holder well in advance of the conference. The auditor and the Principal Auditor, or their designees, should ensure they have equipment readily available to receive scanned copies of documents the taxpayer may present during the conference.

For appeals conferences where the auditor and Principal Auditor represent the Department by telephone, it is not necessary for staff from the host office to attend the conference, since it is the responsibility of the OMA to address all questions raised by the Appeals Division and the taxpayer. However, there may be circumstances in which the Appeals Division requests that staff from the host office attend the conference. Such requests will be handled on a case-by-case basis, with the ultimate discretion remaining with the Administrator of the host office or Headquarters section supervisor (Petitions Section, Appeals and Data Analysis Branch (ADAB), or the Audit Determination and Refund Section). In the absence of such a request, staff from the host office may nevertheless attend the conference at the discretion of the host office’s Principal Auditor, with the consent of the conference holder.

Conferences Involving Consumer Use Tax Appeals

Appeals cases involving consumer use tax liabilities are identified with office code “CUT” in the OMA field on the APL MH screen. Appeals conferences for such cases will generally be held at Headquarters or at a district office. In all instances the Department will be represented by an auditor from the Petitions Section or the Audit Determination and Refund Section (ADRS), in person or by telephone, depending on the location of the appeals conference.

For appeals conferences where a Petitions Section or ADRS auditor will represent the Department by telephone, it is not necessary for staff from the host office to attend the conference. However, there may be circumstance in which the Appeals Division requests that staff from the host office attend the conference. Such requests will be handled on a case-by-case basis, with the ultimate discretion remaining with the Administrator of the host office. In the absence of such a request, staff from the host office may nevertheless attend the conference at the discretion of the host office's Principal Auditor, with the consent of the conference holder.

Conferences Involving Compliance Related Appeals

When the OMA is the Use Tax Administration Section (UTAS), the Department is represented by staff from UTAS, either in person or by telephone depending on the location of the appeals conference. Such cases are identified with office codes CCS, CNO, CSO, or UTA on the APL MH screen.

When the OMA is the Return Analysis Unit (RAU), identified with office code RAU on the APL MH screen, the Department is represented by staff from RAU. When the OMA is the Local Revenue Branch (LRB), identified with the office code LRB on the APL MH screen, the Department is represented by LRB staff or an auditor from ADRS. RAU Staff, LRB Staff, or an auditor from ADRS, represents the Department, in person or by telephone, depending on the location of the appeals conference. When the OMA is the Return Processing Branch, identified with office code ADS on the APL MH screen, the Department is represented by staff from ADAB.

For appeals conferences where RAU staff, LRB staff, an auditor from ADRS or ADAB, or UTAS staff represents the Department by telephone, it is not necessary for staff from the host office to attend the conference. However, there may be circumstances in which the Appeals Division requests that staff from the host office attend the conference. Such requests will be handled on a case-by-case basis, with the ultimate discretion remaining with the Administrator of the host office. In the absence of such a request, staff from the host office may nevertheless attend the conference at the discretion of the host office's Principal Auditor, with the consent of the conference holder.

~~Staff from Petitions or Refunds will normally represent the Department at appeals conferences scheduled in Sacramento Headquarters except for accounts in the Sacramento and Out of State offices. If Petitions, Refunds, or the office believes that because of unusual circumstances or specific issues involved, it is desirable to have an office representative in attendance at a conference held in Headquarters, a written request should be prepared and forwarded to the appropriate Chief or his or her designee, for approval:~~

- ~~1. Chief, Field Operations Division~~
- ~~2. Chief, Special Taxes and Fees Division~~
- ~~3. Chief, Investigations and Special Operations Division~~

Department's Role at Appeals Conference

It is imperative that the Department staff be well prepared to effectively present the Department's case. The field auditor is expected to take an active role in explaining the audit findings during appeals conferences. Prior to the conference, he or she should thoroughly review the audit results, audit findings, and the taxpayer's contentions, [as well as the summary analysis prepared by the Petitions Section or ADAB](#). During the conference, if any conflicting information is presented or if the auditor determines that information given is inconsistent with information contained in the [AWPs audit working papers](#), the auditor must point out the discrepancy to the conference holder.

~~The presence and experience of the DPA provides valuable support for the auditor, lends credibility to the Department's position, and gives the conference holder an additional resource during an appeals conference.~~