

Draft Audit Regulation 19032
Index of Items in Dispute

Category 1 – Comments conflict with the statutory provisions of R&TC 19032 & 21002 as they minimize or eliminate our ability to determine the correct amount of tax during an audit.

1.	Fair vs. Correct Amount of Tax	Page 1
2.	Materiality –Taxpayer Costs Included When Determining Issues to Audit	Page 1
3.	Limitation on IDRs – Maximum 90 Questions etc.	Page 2
4.	FTB Response Period	Page 2

Category 2 – Comments relate to the required use of an Audit Plan, Audit Issue Presentation Sheet, and a Position Letter which may not be used in over 95% of the audits we conduct as they involve single issues or are generated through our automated programs. On the remaining audits, procedures incorporated in manuals generally require the use of the above documents, or the regulation provides a taxpayer may request one if one is not provided. Multistate corporations or representatives with multistate corporate clients presented the comments.

1.	Required Use of Audit Plan	Page 4
2.	Required Use of Audit Issue Presentation Sheet	Page 5
3.	Required Use of Position Letter	Page 6

Category 3 –Comments relate to establishing a general timeframe greater than 30 days for responses to audit inquiries that could affect our ability to complete the audit within 2 years. The regulation establishes a 30-day general guideline for audit inquiries and provides for discretion for alternative response times.

1	Timeframes – standard 90 day response period for IDRs	Page 8
2.	Timeframes – 30 day minimum response period for IDRs	Page 9
3.	Timeframes – standard 90 day response period to Audit Issue Presentation Sheets	Page 9
4.	Timeframes – standard 90 day response period to Position Letters	Page 10

Category 4 –Comments relate to a taxpayer’s ability to determine the location or relocation of an audit any time during the audit at the taxpayer’s request.

1	Location of Audit	Page 12
2.	Relocation of Audit	Page 12

Category 5 –Comments relate to various aspects of the regulatory language.

1.	Exception to 2-year timeframe – Demand Penalty Letter	Page 14
2.	Effective Date of Regulation	Page 15
3.	Disclosure of Audit File Upon Request	Page 15

Category 6 – Comments were received on Proposed Reg. 19504 that has been withdrawn. We did not receive any response as to the relevance of these comments to Proposed Reg. 19032.

1.	Timeframes – tolling for catastrophic events	Page 17
2.	Raising New Issues after an Audit Plan - Prohibited by the Auditor or Taxpayer	Page 17
3.	Timeframes – limited to 20 questions in a 30 day period	Page 19
4.	Timeframes – tolled for 3 rd party requests	Page 19

Proposed Regulation 19032
Discussion Matrix of Alternative Language - Category 1
March 6, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<i>Revisions to Initial Text</i>
<i>Initial Text Suggested for Deletion</i>

Category 1 – Comments conflict with the statutory provisions of R&TC 19032 & 21002 as they minimize or eliminate our ability to determine the correct amount of tax during an audit.

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
1.	(a)(1)	The purpose of the audit is to <u>efficiently</u> determine the correct amount of tax based on an analysis of relevant tax statutes and regulations and case law as applied to the facts of the audit.	The purpose of the audit is to efficiently determine <u>a fair the correct</u> amount of tax based on an analysis of relevant tax statutes and regulations and case law as applied to the facts of the audit.	This language allows for the reality that the exact amount of tax is not often calculable due to non-existent records or the inefficiency of generating every available fact.	<p>Support staff version. Replacing “the correct amount of tax” with “a fair amount of tax” conflicts with R&TC 19032 and 21002 (Taxpayer Bill of Rights) that provides in part “the FTB shall ...determine the correct amount of tax”.</p> <p>The “correct amount of tax” embodies:</p> <ul style="list-style-type: none"> • A well established and recognized application of an audit standard, and • Compares to federal and other state audit standards. <p>4/23/01 symposium comments: Participants’ were neutral or supported including “efficiently”, but excluding “a fair” amount of tax.</p>
2.	(a)(7)	<u>Materiality. Audit issues are based on the materiality of the potential adjustment and balanced with the statutory requirement to determine the correct amount of tax. If potential for an audit adjustment is likely, the issue should be pursued if the materiality of the potential adjustment warrants the audit resources necessary to audit the</u>	<u>Materiality. Audit issues are based on the materiality of the potential adjustment. Even if potential for an audit adjustment is likely, the issue should not be pursued if the materiality of the potential adjustment does not warrant the auditor and taxpayer resources necessary to audit the issue. The auditor and taxpayer will use judgment as to what constitutes the</u>	<p>The cost of the examination to the taxpayer should be factored into the materiality analysis of the audit.</p> <p>04/23/01 symposium comments: Participants’ agreed that materiality must be considered in the audit, but did not clearly support that the taxpayer’s cost must be included in the</p>	<p>Support staff version. The resources used in the determination of materiality differ for each taxpayer and cannot be determined prior to starting the audit engagement. Considering the taxpayer’s costs would:</p> <ul style="list-style-type: none"> • deviate from well established audit standards applied in any audit function, such as financial audits and public accounting audits, • cause inconsistent audit standards and approaches between different taxpayers which produces an inequitable result and fosters inconsistent administration,

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		<u>issue. Auditors will use judgment as to what constitutes materiality for purposes of this subsection as materiality is a facts and circumstances test. The auditor will discuss materiality at any time during the audit if so requested.</u>	<u>relevant materiality level for purposes of this subdivision.</u>	calculation. A participant felt that materiality needed to be considered throughout the audit and the threshold for new issues increased as the audit progressed. (Participant was asked to provide alternative language. None has been provided to date.)	<ul style="list-style-type: none"> • reward those taxpayers that do not keep and maintain orderly and accurate records, thus, their costs of the audit are increased, and penalizes those that keep and maintain records, • interfere with the principle of self-compliance as a taxpayer could successfully argue the issue is immaterial, and thus, not subject to audit, • cause disputes related to what a material issue is, thus delaying completion of the audit, • jeopardize the determination of “the correct amount of tax” as required by R&TC 19032 and 21002, and • jeopardize the efficient use of audit resources. <p>04/23/01 symposium comments: Staff recognizes that materiality is a factor for consideration throughout the audit and believes the staff version language accomplishes this result. The establishment of a materiality threshold is generally specific to an issue.</p>
3.	(b)(5)(C)(1)	No language.	<p><u>IDR Content. No IDR may exceed 30 questions, and no more than 3 such IDRs (not exceeding 90 questions) will be issued during an examination.</u></p> <p><u>a. IDRs must be specific as to questions asked and documents requested.</u></p> <p><u>b. IDRs may not request the taxpayer to produce any new documents or schedules.</u></p> <p><u>c. Each IDR shall not require the production of more than 50 pages of documents.</u></p>	<p>IDRs are voluminous and include information requests believed to be irrelevant. Further, a significant amount of documentation needs to be provided or produced to accommodate the IDRs.</p> <p>04/23/01 symposium comments: Taxpayer must have the right to submit information necessary to support their return position without limitation. Participants’ were neutral or supported staff version.</p>	<p>Support staff version. Limiting the amount of information requested or questions asked will jeopardize the auditor’s ability to determine all necessary and relevant facts to determine the correct amount of tax (R&TC 19032 & 21002), and impacts the ability to conduct a fair and effective examination. Also, resolution of a protest, appeal, or suit for refund may be affected if full development of the audit case cannot occur during the audit.</p> <p>Requests for documentation must be relevant and reasonable to the audit issue as stated in subsections (a)(3) and (a)(4).</p>
4.	(b)(5)(C)(1)	As a general rule, where a reply by the auditor is appropriate or the auditor needs additional information, the auditor will notify	As a general rule, where a reply by the auditor is appropriate or the auditor needs additional information, the auditor will notify the taxpayer or	A timeframe for response by FTB to documents provided should be stated.	Support staff version as participant’s comment is addressed by revised staff version language. As a general rule, the auditor will respond within 30 days by accomplishing one of the listed actions identified in staff

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		<p>the taxpayer or the taxpayer’s representative within 30 days of the auditor’s receiving the response to the Information Document Request. <u>Notification is achieved by issuance of additional IDRs, an Audit Issue Presentation Sheet or Position Letter, or by a response indicating additional time is necessary to respond and providing a date for future contact.</u></p>	<p>the taxpayer’s representative within 30 days of the auditor’s receiving the response to the IDR. <u>If no requests for additional information are made by the FTB within 30 days, the taxpayer may assume that the response was adequate.</u></p>	<p>04/23/01 symposium comments: None.</p>	<p>language. However, imposing a limitation on further requests for information absent a response from the auditor, and thus assuming the response previously provided is adequate, will jeopardize the auditor’s ability to determine all necessary and relevant facts to determine the correct amount of tax (R&TC 19032 & 21002), and impacts the auditor’s ability to conduct a fair and effective examination</p> <p>In certain situations, 30 days will not be a sufficient period to determine whether the response is adequate, particularly in relation to:</p> <ul style="list-style-type: none"> • complex audit issues, • issues where multiple documents need to be reviewed to gain an understanding of the tax transaction and sometimes these documents are provided piece-meal or not at all, or • third-party documentation requests, authorized by the taxpayer.

Proposed Regulation 19032
Discussion Matrix of Alternative Language – Category 2
January 10, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<u>Revisions to Initial Text</u>
<u>Initial Text Suggested for Deletion</u>

Category 2 – Comments relate to the required use of an Audit Plan, Audit Issue Presentation Sheet, and a Position Letter which may not be used in over 95% of the audits we conduct as they involve single issues or are generated through our automated programs. On the remaining audits, procedures incorporated in manuals generally require the use of the above documents, or the regulation provides a taxpayer may request one if one is not provided. Multistate corporations or representatives with multistate corporate clients presented the comments.

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1.	(b)(5)(B)	<u>Audit Plan. A written audit plan may be drafted as appropriate, or if requested by the taxpayer, documenting key dates related to conducting the examination, identifying key points of the examination, or identifying other items discussed during the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer’s representative. The audit plan is considered a guideline for conducting the examination and can be amended throughout the audit process as circumstances warrant.</u>	<u>A written audit plan will be drafted documenting time limits for conducting the audit with references to specific dates, and including a description of the specific issues the auditor will examine. The audit plan will be signed by both the auditor and taxpayer or the taxpayer’s representative. After this time, and in the absence of fraud, the auditor may not extend the scope of the audit beyond that set forth in the audit plan.</u>	<p>To accommodate the 2-year time period for completion of an audit, all issues to be reviewed during the examination should be stated up front and in the audit plan.</p> <p>This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to.</p> <p>4/23/01 symposium comments: Participants’ were neutral or supported staff version.</p>	<p>Support staff version. Limiting the scope of the audit to that set forth in the audit plan, drafted after a review of the tax return, would undermine the fairness of the examination process and circumvent the statutory requirement that an audit be conducted to determine the correct amount of tax. (R&TC 19032 & 21002)</p> <p>Depending on the size of the taxpayer, tax returns generally summarize many tax situations for a given tax year. Transactions are aggregated, or the taxpayer may simply state that the information will be available upon request. Generally, audit issues and adjustments are identified from reviewing the taxpayer’s supporting workpapers than from review of the tax return.</p> <p>To require the identification of issues prior to the issuance of an audit plan would require extensive information to be filed with the return that currently is not required to be filed under existing law, thus increasing the filing burden as well as the increasing the intrusiveness of the audit process. Under this provision FTB could not issue an assessment, or grant a refund, if a statutory adjustment was not identified on the face of</p>

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					<p>the tax return but was identified in the supporting workpapers.</p> <p>“May” recognizes that an audit plan is not used in all audits performed by FTB. Ninety five per cent of FTB's audits are single issue - automated audits or statutory adjustments - where an audit plan is not an efficient or useful tool. Issuance of an audit plan in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit.</p> <p>Comments that an audit plan should be required have been received from multistate taxpayers subject to field examination. Generally, in this type of audit, staff will issue an audit plan. Taxpayer’s concerns have been addressed in the regulation by amending the language to provide that the taxpayer may request an audit plan if desired, if one is not otherwise provided.</p>
2.	(b)(5)(F)	<p><u>Audit Issue Presentation Sheet (AIPS)</u>. An Audit Issue Presentation Sheet (AIPS) may be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. <u>If an AIPS is not provided, the taxpayer or the taxpayer’s representative may request one.</u> AIPS provide the facts, law, <u>analysis</u>, and <u>the auditor’s tentative</u> conclusion concerning a specific issue. The taxpayer will be asked to provide a response confirming or denying the correctness of the factual</p>	<p><u>Audit Issue Presentation Sheet (AIPS)</u>. Depending on the type of audit, an Audit Issue Presentation Sheet (AIPS) <u>may must</u> be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. AIPS provide the facts, law and conclusion concerning a specific issue. The taxpayer will be asked to provide a response confirming or denying the correctness of the factual description of the issue and will be provided an opportunity to provide additional facts and documents or other authority to rebut the auditor’s</p>	<p>Currently, many taxpayers have no idea what the final determination will be prior to the issuance of the Notice of Proposed Assessment. Forcing the FTB to issue the Audit Issue Presentation Sheet in every audit will remedy this problem and lead to resolution of issues at the audit level. The 30-day time limit should be changed to 90 days. This is a crucial segment of the audit process and 30 days is simply not enough time to review the issues and respond.</p> <p>04/23/01 symposium comments:</p>	<p>Support staff version. “May” recognizes that AIPS are not used in all audits performed by FTB. Ninety five per cent of FTB's audits are single issue - automated audits or statutory adjustments - where position letters or NPAs are used to inform taxpayers of audit results. Issuance of an AIPS in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit.</p> <p>Staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time. Discretionary allowances of extensions, as provided in subsection (a)(6), continue to allow for resolution of issues at the</p>

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		description of the issue and will be provided an opportunity to provide additional facts and documents or other authority to rebut the auditor’s conclusion within a period not to exceed 30 days from the date the AIPS was hand delivered to the taxpayer, <u>or the taxpayer’s representative</u> by the auditor or the date mailed by the auditor <u>or as otherwise provided for in subsection (a)(6)(A) of this regulation.</u>	conclusion within a period not to exceed 30 <u>90</u> days from the date the AIPS was hand delivered to the taxpayer by the auditor or the date mailed by the auditor.	Participants’ felt “must” was more appropriate to use as an AIPS should be issued. “May” allowed for discretion, which they did not concur with. Participants’ did recognize that AIPS were not used in all audits conducted and requested the regulation incorporate the provision that the AIPS would be provided if requested.	audit level and promote the 2-year guideline for completing the examination. 04/23/01 symposium comments: “May” was used solely to recognize that AIPS are not an effective or efficient tool for use in all audits conducted by staff. In those audits conducted where an AIPS is relevant, the AIPS will be used. The participant’s concern has been addressed in staff language providing that in the event an AIPS is not issued, the taxpayer has the right to request one.
3.	(b)(5)(H)	<p><u>Position Letter. At the close of an audit, the auditor may provide, or the taxpayer or the taxpayer’s representative may request. The auditor will provide</u> a position letter at the close of the audit. The position letter will explain the facts relied on, relevant law, <u>analysis</u>, and conclusions <u>on all adjusted audit issues</u>, or may refer to previous AIPS.</p> <p>(1) Audit schedules, as applicable, will be provided with the position letter.</p> <p>(2) The taxpayer or the taxpayer’s representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 days from the date the closing letter was hand delivered to the taxpayer, <u>or the taxpayer’s representative</u> by the auditor or the date mailed by the</p>	<p><u>Position Letter.</u> The auditor will provide a position letter at the close of the audit. The position letter will explain the facts relied on, relevant law and conclusions, or may refer to previous AIPS. Audit schedules, as applicable, will be provided to the taxpayer and taxpayer’s representative. The taxpayer or the taxpayer’s representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 <u>90</u> days from the date the closing letter was hand delivered to the taxpayer by the auditor or the date mailed by the auditor. If the taxpayer or the taxpayer’s representative responds to the closing letter with additional facts or authorities for the auditor to consider, the auditor will issue a revised closing letter to take into account the additional facts or authorities.</p>	<p>Typically, internal mail processes do not allow for the taxpayer to timely receive the position letter. Thus, sufficient time to review and respond to the position letter does not exist.</p> <p>It is believed that the 30-day timeframe will be used to justify the premature closure of the audit case.</p> <p>04/23/01 symposium comments: Participants’ felt “must” was more appropriate to use as a position letter should be issued. “May” allowed for discretion, which they did not concur with. Participants’ did recognize that position letters were not used in all audits conducted and requested the regulation incorporate the provision that a position letter would be provided if requested.</p>	<p>Support staff version as participant’s concern is addressed in subsection (a)(6) of this regulation. Staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time. Discretionary allowances of extensions, as provided in subsection (a)(6), continue to allow for resolution of issues at the audit level and promote the 2-year guideline for completing the examination.</p> <p>“May” recognizes that position letters are not used in all audits performed by FTB. Ninety five per cent of FTB’s audits are single issue - automated audits or statutory adjustments - where NPAs are used to inform taxpayers of audit results. Issuance of a position letter in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit.</p> <p>04/23/01 symposium comments: “May” was used solely to recognize that a position letter is not an effective or efficient tool for use in all audits conducted by staff. In audits conducted where a position letter is</p>

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		<p><i>auditor <u>or as otherwise provided for in subsection (a)(6)(A) of this regulation.</u></i></p> <p>(3) If the taxpayer or the taxpayer’s representative responds to the closing letter with additional facts or authorities for the auditor to consider, the auditor will issue a revised closing letter to take into account the additional facts or authorities.</p>		<p>Post Symposium Comment: Taxpayers have voiced concerns that they do not know the tax adjustments prior to the issuance of the Notice of Proposed Assessment. The requirement to issue an AIPS or position letter for all large case audits would address this concern.</p>	<p>relevant, the position letter will be used. The participant’s concern has been addressed in staff language providing that in the event a position letter is not issued, the taxpayer has the right to request one.</p> <p>Post Symposium Comment: Audit procedures require the issuance of a position letter on all field audits prior to the issuance of a Notice of Proposed Assessment.</p>

Proposed Regulation 19032
Discussion Matrix of Alternative Language – Category 3
January 10, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<i>Revisions to Initial Text</i>
<i>Initial Text Suggested for Deletion</i>

Category 3 –Comments relate to establishing a general timeframe greater than 30 days for responses to audit inquiries that could affect our ability to complete the audit within 2 years. The regulation establishes a 30-day general guideline for audit inquiries and provides for discretion for alternative response times.

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
1.	(b)(5)(C) Alternative #1	<u>Information Document Request (IDR). The Franchise Tax Board may provide a taxpayer an Information Document Request (IDR) requesting single or multiple documents. As a general rule, response times shall be determined on an IDR by IDR basis with a maximum response time of 30 days from the date the IDR was hand delivered to the taxpayer, <u>or the taxpayer’s representative</u> by the auditor or the date mailed by the auditor <u>or as otherwise provided for in subsection (a)(6)(A) of this regulation.</u></u>	<u>Information Document Request (IDR). The Franchise Tax Board may provide a taxpayer an Information Document Request (IDR) requesting single or multiple documents. As a general rule, response times shall be determined on an IDR by IDR basis with a maximum response time of 30 <u>90</u> days from the date the IDR was hand delivered to the taxpayer by the auditor or mailed by the auditor. Extensions may be granted providing the audit is progressing towards completion in accordance with the agreed timeframes established at the beginning of the audit.</u>	Typically, internal mail processes do not allow for the taxpayer to receive the IDRs timely, or the taxpayer does not contact the representative timely. Once the IDR is received, obtaining information may take a significant amount of time. It is believed that the 30-day timeframe will be used to justify the increase in the assessment of the failure to furnish information penalty, and the premature closure of the audit case. 04/23/01 symposium comments: Participants expressed concern regarding the 30-day response period for addressing each IDR. Participants’ felt audit staff needed to have the ability to apply discretion and should actually apply discretion based on the taxpayer’s facts and	Support staff version as participant’s concern is addressed in subsection (a)(6) of this regulation. Staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time. Discretionary allowances of extensions, as provided in subsection (a)(6), continue to allow for resolution of issues at the audit level and promote the 2-year guideline for completing the examination. 04/23/01 symposium comments: Participants’ concern is addressed in subsection (a)(6) that allows the auditor discretion as appropriate in determining timeframes for responses.

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				circumstances. Open discussion between the taxpayer and auditor before issuing IDRs should occur.	
2.	(b)(5)(C) Alternative #2	See Alternative #1. (Category 3, Item 1 above).	<u>Information Document Request (IDR)</u> . The Franchise Tax Board may provide a taxpayer an Information Document Request (IDR) requesting single or multiple documents. As a general rule, response times shall be determined on an IDR by IDR basis with a maximum <u>minimum</u> response time of 30 days from the date the IDR was hand delivered to the taxpayer by the auditor or mailed by the auditor. Extensions may be granted providing the audit is progressing towards completion in accordance with the agreed timeframes established at the beginning of the audit, <u>or as agreed to by the auditor and taxpayer (or taxpayer’s representative)</u> .	See Alternative #1 (Category 3, Item 1 above). 04/23/01 symposium comments: See Alternative #1.	Support staff version as participant’s concern is addressed in subsection (a)(6) of this regulation. See Alternative #1, (Category 3, Item 1 above). 04/23/01 symposium comments: Participants’ concern is addressed in subsection (a)(6) that allows the auditor discretion as appropriate in determining timeframes for responses.
3.	(b)(5)(F)	<u>Audit Issue Presentation Sheet (AIPS)</u> . An Audit Issue Presentation Sheet (AIPS) may be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. <u>If an AIPS is not provided, the taxpayer or the taxpayer’s representative may request one.</u> AIPS provide the facts, law, <u>analysis, and the auditor’s tentative</u> conclusion concerning a specific issue. The taxpayer will be asked to provide a response	<u>Audit Issue Presentation Sheet (AIPS)</u> . Depending on the type of audit, an Audit Issue Presentation Sheet (AIPS) <u>may must</u> be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. AIPS provide the facts, law and conclusion concerning a specific issue. The taxpayer will be asked to provide a response confirming or denying the correctness of the factual description of the issue and will be provided an opportunity to provide	Currently, many taxpayers have no idea what the final determination will be prior to the issuance of the Notice of Proposed Assessment. Forcing the FTB to issue the Audit Issue Presentation Sheet in every audit will remedy this problem and lead to resolution of issues at the audit level. The 30-day time limit should be changed to 90 days. This is a crucial segment of the audit process and 30 days is simply not enough time to review the issues and respond.	Support staff version. “May” recognizes that AIPS are not used in all audits performed by FTB. Ninety five per cent of FTB’s audits are single issue - automated audits or statutory adjustments - where position letters or NPAs are used to inform taxpayers of audit results. Issuance of an AIPS in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit. Staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time. Discretionary

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		confirming or denying the correctness of the factual description of the issue and will be provided an opportunity to provide additional facts and documents or other authority to rebut the auditor’s conclusion within a period not to exceed 30 days from the date the AIPS was hand delivered to the taxpayer, <u>or the taxpayer’s representative</u> by the auditor or the date mailed by the auditor <u>or as otherwise provided for in subsection (a)(6)(A) of this regulation.</u>	additional facts and documents or other authority to rebut the auditor’s conclusion within a period not to exceed 30 <u>90</u> days from the date the AIPS was hand delivered to the taxpayer by the auditor or the date mailed by the auditor.	04/23/01 symposium comments: Participants’ felt “must” was more appropriate to use as an AIPS should be issued. “May” allowed for discretion, which they did not concur with. Participants’ did recognize that AIPS were not used in all audits conducted and requested the regulation incorporate the provision that the AIPS would be provided if requested.	allowances of extensions, as provided in subsection (a)(6), continue to allow for resolution of issues at the audit level and promote the 2-year guideline for completing the examination. 04/23/01 symposium comments: “May” was used solely to recognize that AIPS are not an effective or efficient tool for use in all audits conducted by staff. In those audits conducted where an AIPS is relevant, the AIPS will be used. The participant’s concern has been addressed in staff language providing that in the event an AIPS is not issued, the taxpayer has the right to request one.
4.	(b)(5)(H)	<p><u>Position Letter. At the close of an audit, the auditor may provide, or the taxpayer or the taxpayer’s representative may request. The auditor will provide</u> a position letter <u>at the close of the audit.</u> The position letter will explain the facts relied on, relevant law, <u>analysis</u>, and conclusions <u>on all adjusted audit issues</u>, or may refer to previous AIPS.</p> <p>(1) Audit schedules, as applicable, will be provided with the position letter.</p> <p>(2) The taxpayer or the taxpayer’s representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 days from the date the closing letter was hand delivered to the taxpayer, <u>or the</u></p>	<p><u>Position Letter.</u> The auditor will provide a position letter at the close of the audit. The position letter will explain the facts relied on, relevant law and conclusions, or may refer to previous AIPS. Audit schedules, as applicable, will be provided to the taxpayer and taxpayer’s representative. The taxpayer or the taxpayer’s representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 <u>90</u> days from the date the closing letter was hand delivered to the taxpayer by the auditor or the date mailed by the auditor. If the taxpayer or the taxpayer’s representative responds to the closing letter with additional facts or authorities for the auditor to consider, the auditor will issue a revised closing letter to take into account the additional facts or</p>	<p>Typically, internal mail processes do not allow for the taxpayer to timely receive the position letter. Thus, sufficient time to review and respond to the position letter does not exist.</p> <p>It is believed that the 30-day timeframe will be used to justify the premature closure of the audit case.</p> <p>04/23/01 symposium comments: Participants’ felt “must” was more appropriate to use as a position letter should be issued. “May” allowed for discretion, which they did not concur with. Participants’ did recognize that position letters were not used in all audits conducted and requested the regulation incorporate the provision that a position letter</p>	<p>Support staff version as participant’s concern is addressed in subsection (a)(6) of this regulation. Staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time. Discretionary allowances of extensions, as provided in subsection (a)(6), continue to allow for resolution of issues at the audit level and promote the 2-year guideline for completing the examination.</p> <p>“May” recognizes that position letters are not used in all audits performed by FTB. Ninety five per cent of FTB’s audits are single issue - automated audits or statutory adjustments - where NPAs are used to inform taxpayers of audit results. Issuance of a position letter in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit.</p> <p>04/23/01 symposium comments: “May” was used solely to recognize that a position letter is not an</p>

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
		<p><u>taxpayer’s representative</u> by the auditor or the date mailed by the auditor <u>or as otherwise provided for in subsection (a)(6)(A) of this regulation.</u></p> <p>(3) If the taxpayer or the taxpayer’s representative responds to the closing letter with additional facts or authorities for the auditor to consider, the auditor will issue a revised closing letter to take into account the additional facts or authorities.</p>	<p>authorities.</p>	<p>would be provided if requested.</p> <p>Post Symposium Comment: Taxpayers have voiced concerns that they do not know the tax adjustments prior to the issuance of the Notice of Proposed Assessment. The requirement to issue an AIPS or position letter for all large case audits would address this concern.</p>	<p>effective or efficient tool for use in all audits conducted by staff. In audits conducted where a position letter is relevant, the position letter will be used. The participant’s concern has been addressed in staff language providing that in the event a position letter is not issued, the taxpayer has the right to request one.</p> <p>Post Symposium Comment: Audit procedures require the issuance of a position letter on all field audits prior to the issuance of a Notice of Proposed Assessment.</p>

Proposed Regulation 19032
Discussion Matrix of Alternative Language – Category 4
January 10, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<i>Revisions to Initial Text</i>
<i>Initial Text Suggested for Deletion</i>

Category 4 –Comments relate to a taxpayer’s ability to determine the location or relocation of an audit any time during the audit at the taxpayer’s request.

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
1.	(b)(2)(B)	<u>Location of Field Audit.</u> A field audit will generally take place at the location where the taxpayer’s original books, records, and source documents pertinent to the audit are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer’s principal place of business. Field audits can be moved to a Franchise Tax Board office, <u>or the taxpayer’s representative’s office</u> , if the taxpayer (or the taxpayer’s representative) does not have the appropriate work area available, or the taxpayer or the taxpayer’s representative does not have time available for the audit to be conducted at their location, <u>or as circumstances of the taxpayer warrant.</u>	<u>Location of Field Audit.</u> A field audit will generally take place at the location where the taxpayer’s original books, records, and source documents pertinent to the audit are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer’s principal place of business. Field audits can be moved to a Franchise Tax Board or the tax representative’s office if the taxpayer or the taxpayer’s representative does not have the appropriate work area available or the taxpayer or the taxpayer’s representative does not have time available for <u>no longer desires that</u> the audit to be conducted at their location.	04/23/01 symposium comments: Staff version language does not recognize the taxpayer’s right of refusal regarding on site audits in the event the audit began at the taxpayer’s office, but they later wish to relocate the audit.	Support staff version as participants’ concerns are addressed in staff’s version of subsection (b)(2)(B) and (b)(2)(D). Staff believes it is appropriate to address situations where staff <i>or</i> the taxpayer may have the need to relocate an audit. The participant’s alternative language does not recognize the reasons for audit staff needing to request a relocation of an audit, and does not recognize the statutory language of R&TC 19504 which provides in part “The Franchise Tax Board, for the purpose of administering its duties under this part, including ascertaining the correctness of any return.....shall have the power to require by demand, that an entity.....provide information or make available for examination or copying at a specified time and place,any book,which may be relevant to that purpose.” Staff version has been updated to reflect the participant’s suggested language as it falls within the category of “as circumstances of the taxpayer warrant”, thus, allowing for consideration of relocation due to the taxpayer’s desire, or for other business reasons.
2.	(b)(2)(D)	<u>Requests by Taxpayers to Change Place of Audit.</u> The Franchise Tax Board staff will	<u>Requests by Taxpayers to Change Place of Audit.</u> The Franchise Tax Board will consider, on a case-by-	Taxpayers should have the ability to request a relocation of an audit.	Support staff version. Requests to relocate an audit will be considered based on the applicable circumstances so that FTB and taxpayer costs are

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
		<p>consider, on a case-by-case basis, written requests by taxpayers or their representatives to change the place that the Franchise Tax Board staff has set for an audit. <u>Reasonable requests to move an audit to another of the taxpayer’s offices or to the taxpayer’s representative’s office will be granted unless doing so would impose an unreasonable burden to the Franchise Tax Board staff or significantly interrupt the audit schedule.</u></p> <p>If the taxpayer requests that the audit be conducted at a Franchise Tax Board office <u>or the taxpayer’s representative’s office</u>, it is the taxpayer’s responsibility to deliver all books and records necessary for the audit.</p>	<p>case basis, written requests by taxpayers or their representatives to change the place that the Franchise Tax Board has set for an audit. <u>Generally, reasonable requests to move an audit to another of the taxpayer’s offices or to the representative’s office will be granted.</u> If the taxpayer requests that the audit be conducted at a Franchise Tax Board office, it is the taxpayer’s responsibility to deliver all books and records necessary for the audit to the Franchise Tax Board office.</p>	<p>04/23/01 symposium comments: A legal requirement does not exist that supports staff denial of a request for relocation of an audit. Staff version implies that such a legal basis exists.</p>	<p>minimized and the audit can progress towards completion in a timely manner.</p> <p>04/23/01 symposium comments: Statutory language of R&TC 19504 provides in part “The Franchise Tax Board, for the purpose of administering its duties under this part, including ascertaining the correctness of any return....shall have the power to require by demand, that an entity.....provide information or make available for examination or copying at a specified time and place,any book,which may be relevant to that purpose.” Further guidelines for establishing the location of an audit can be found in federal regulations, tax procedures and rulings. Generally, location of records allowing for easy or timely access to supporting information is the most relevant and reasonable test for determining location of an audit. These guidelines are used in the initial determination of where an audit is conducted and are again considered in the event relocation of an audit is requested.</p>

Proposed Regulation 19032
Discussion Matrix of Alternative Language – Category 5
January 10, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<i>Revisions to Initial Text</i>
<i>Initial Text Suggested for Deletion</i>

Category 5 –Comments relate to various aspects of the regulatory language.

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
1.	(a)(2)(C)	Audits in which a demand for information letter citing the failure to furnish information penalty, Revenue and Taxation Code section 19133 has been sent to the taxpayer or the taxpayer’s representative.	Audits in which a demand for information letter citing the failure to furnish information penalty, Revenue and Taxation Code section 19133 has been sent to the taxpayer or the taxpayer’s representative.	<p>The statutory provision of the penalty provides its own remedy for resolution; thus, a tolling of the 2-year timeframe is unnecessary. Also, concern was expressed that the auditor would issue the threat of the penalty in order to avoid the 2-year timeframe for completing the examination.</p> <p>4/23/01 symposium comments: Participants’ expressed concern that the auditor will inappropriately apply the demand penalty to thwart the 2-year completion goal. Participants’ were asked how to resolve staff concern about premature closing when information is untimely provided, late in the audit. None favored premature closing to meet the 2-year guideline, but alternative language was not submitted to resolve all concerns.</p>	<p>Support staff version. In certain situations, taxpayers only begin providing information after a formal legal demand for information has been issued. For these taxpayers, adhering to the 2-year timeframe may result in the issuance of an incorrect deficiency notice, or the incorrect denial of a refund.</p> <p>The goal of completing the audit of a complex tax return within two years can only be accomplished with taxpayer cooperation. The issuance of the demand letter is done only in the event the taxpayer is not cooperating during the audit and requires a detailed and timely process before the penalty can be assessed. Generally, only after two requests for information will the demand be issued.</p> <p>The business community appears to dislike the use of the failure to furnish information penalty. However, the SBE admonished the department in the <u>Appeal of Allied-Signal</u>, adopted Feb. 24, 2000, for not fully utilizing "the procedural devices at its disposal to obtain the necessary evidence at the earliest possible date." The failure to furnish information penalty is a procedural device to obtain information.</p>

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
					<p>If concerns exist regarding the incorrect application of the penalty, discussions with the auditor, their supervisor, manager or Taxpayer Advocate, are encouraged.</p> <p>4/23/01 symposium comments: The greatest risk to taxpayers is associated with the premature closure of an audit when the taxpayer failed to initially provide information but has begun providing information towards the later part of the audit. If an audit where a demand to furnish information has been issued is not exempt from the 2-year timeframe, thus requiring premature closure, the auditor’s ability to determine all necessary and relevant facts will be jeopardized impacting the auditor’s ability to conduct a fair and effective examination.</p>
2.	(a)(8)	<p>This regulation shall be applicable for initial audit contacts made on or after January 1, 2002 <u>the effective date of this regulation within the meaning of Government Code Section 11343.4.</u></p>	<p>This regulation shall <u>apply to audits that relate to taxable years ending on or after December 31, 2001.</u> be effective for initial audit contacts made on or after January 1, 2002. <u>Audits for years ending before December 31, 2001 shall be expeditiously completed by the Franchise Tax Board within the spirit of this regulation for fairness, timeliness and completeness of examinations.</u></p>	<p>Provisions of audit regulations should be prospective related to beginnings of audits, with earlier voluntary compliance allowed for. This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to.</p> <p>04/23/01 symposium comments: Participants’ supported earlier adoption date as audit staff is already applying regulation procedures. Participants’ suggested there was no need to wait 2 – 3 years for audits of 2002 taxable year.</p>	<p>Support staff version. Staff supports a prospective effective date. In both versions, date of implementation is prospective by reference to initial contact letters, or to tax years filed. Staff version provides for an earlier effective date than alternative language. As the regulation reflects current audit practices and procedures, earlier voluntary application is possible.</p> <p>Application of the regulation provisions prior to the effective date is a matter appropriately addressed in the Statement of Reasons supporting this regulation but should not be incorporated into the regulation so as to create a legal standard which is unintended or which may jeopardize either a taxpayer or the Franchise Tax Board by requiring the application of guidelines of which neither are familiar with or able to abide by.</p>
3.	(b)(5)(l)	<p><u>Copy of the Audit File. If requested by the taxpayer, or taxpayer’s representative, a copy of the audit file will be provided to the extent not prohibited by law or</u></p>	<p><u>Copy of the Audit File. If requested, the letter and a complete set of audit working papers including all comments and written memoranda will be provided to the taxpayer and</u></p>	<p>A complete set of workpapers and audit documents should be provided to allow the taxpayer or representative to obtain a full understanding of the audit</p>	<p>Support staff version as reference in the regulation to “laws and privileges” provides notification to a taxpayer that the entire audit file may not be provided to them upon request as certain laws and privileges prevent that disclosure. To the extent allowed, the audit file will be</p>

Item	Subdivision	Staff Version – Staff Recommends Adoption of This Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
		<u>protected by privilege.</u>	<u>taxpayer’s representative.</u>	determination. 04/23/01 symposium comments: Privileges or law provisions supporting the withholding of these documents do not exist.	provided upon request. Failure to reference these laws and privileges in the regulation may result in confusion when the laws and privileges are relied upon to redact information from the audit file. Laws and privileges related to the matter of withholding information are a subject matter outside the scope of this regulation.

Proposed Regulation 19032
Discussion Matrix of Alternative Language - Category 6
January 10, 2002

Index Defining Changes

Initial text of Proposed Regulation 19032
<u>Revisions to Initial Text</u>
<u>Initial Text Suggested for Deletion</u>

Category 6 – Comments were received on Proposed Reg. 19504 that has been withdrawn. We did not receive any response as to the relevance of these comments to Proposed Reg. 19032.

Item	Subdivision	Staff Version – Staff Recommends Adoption of this Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
1.	<u>(a)(6)(A)</u>	No language. Issue addressed by language in subsections (a)(3), (a)(4), and (a)(6).	<u>If due to illness, injury, or death of the taxpayer (or the taxpayer’s employee) involved in the audit process or the taxpayer’s representative, or the lead auditor, or if a catastrophic event such as an earthquake, flood, fire, act of war, act of terrorism, etc renders the taxpayer’s office, the taxpayer’s representative’s office, or the FTB office that has responsibility for the audit unusable and as a result an extension of time beyond that set forth herein is required, the audit will stop for a period of 180 days, all deadlines will be tolled (subject to the statute of limitations) and 180 days will be added to the deadline for completion of the audit.</u>	Automatic tolling for catastrophic events should be provided. This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to. 04/23/01 symposium comments: None.	Support staff version as the participant’s concern is addressed primarily by current Department practices, and by the provisions of subsections (a)(3), (a)(4), and (a)(6) of this regulation. Department practice currently requires the temporary suspension of all audit activity in geographic areas designated disaster areas unless the taxpayer waives the delay, or an impending expiration of the statute of limitation requires the continuation of audit activity. Further, staff recommends that all timeframes for responses be left at 30 days but allowing discretion to be applied regarding appropriate extensions of time to allow for resolution of issues at the audit level.
2.	(b)(5)(B)	<u>Audit Plan. A written audit plan may be drafted as appropriate, or if requested by the taxpayer, documenting key dates related to conducting the examination,</u>	<u>A written audit plan will be drafted documenting time limits for conducting the audit with references to specific dates, and including a description of the specific issues the</u>	To accommodate the 2-year time period for completion of an audit, all issues to be reviewed during the examination should be stated up front and in the audit plan.	Support staff version. Limiting the scope of the audit to that set forth in the audit plan, drafted after a review of the tax return, would undermine the fairness of the examination process and circumvent the statutory requirement that an audit be conducted to determine the

Item	Subdivision	Staff Version – Staff Recommends Adoption of this Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
		<p><u>identifying key points of the examination, or identifying other items discussed during the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer’s representative. The audit plan is considered a guideline for conducting the examination and can be amended throughout the audit process as circumstances warrant.</u></p>	<p><u>auditor will examine. The audit plan will be signed by both the auditor and taxpayer or the taxpayer’s representative. After this time, and in the absence of fraud, the auditor may not extend the scope of the audit beyond that set forth in the audit plan.</u></p>	<p>This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to.</p> <p>4/23/01 symposium comments: Participants’ were neutral or supported staff version.</p>	<p>correct amount of tax. (R&TC 19032 & 21002)</p> <p>Depending on the size of the taxpayer, tax returns generally summarize many tax situations for a given tax year. Transactions are aggregated, or the taxpayer may simply state that the information will be available upon request. Generally, audit issues and adjustments are identified from reviewing the taxpayer’s supporting workpapers than from review of the tax return.</p> <p>To require the identification of issues prior to the issuance of an audit plan would require extensive information to be filed with the return that currently is not required to be filed under existing law, thus increasing the filing burden as well as the increasing the intrusiveness of the audit process. Under this provision FTB could not issue an assessment, or grant a refund, if a statutory adjustment was not identified on the face of the tax return but was identified in the supporting workpapers.</p> <p>“May” recognizes that an audit plan is not used in all audits performed by FTB. Ninety five per cent of FTB’s audits are single issue - automated audits or statutory adjustments - where an audit plan is not an efficient or useful tool. Issuance of an audit plan in these types of audits will cause an increase in the time spent by audit staff on the audit, and may cause confusion for those taxpayers undergoing one of these types of audits, thus, resulting in increased time and costs for the taxpayer in order to resolve the audit.</p> <p>Comments that an audit plan should be required have been received from multistate taxpayers subject to field examination. Generally, in this type of audit, staff will issue an audit plan. Taxpayer’s concerns have been addressed in the regulation by amending the language to provide that the taxpayer may request an audit plan if</p>

Item	Subdivision	Staff Version – Staff Recommends Adoption of this Language	Participant’s Version – Alternative Language for Discussion	Participant’s Response	Staff Response
					desired, if one is not otherwise provided.
3.	(b)(5)(C)(1) Alternative #2 - See Category 1, Item 3	No language. Issue addressed by language in subsection (a)(6).	<u><i>If 10 or more IDRs are issued within a 30-day period, the issuance of the 10th IDR shall give rise to a 30-day extension for all then outstanding IDRs. No more than 20 IDRs shall be issued in any 30-day period.</i></u> <u><i>a. For purposes of determining time limits for responses to IDRs as discussed in subsection (b)(5)(B)(1), each question asked by FTB shall constitute one IDR.</i></u>	Gathering information generally takes in excess of 30 days. The more documents requested, the longer it takes. Each question asked should be considered 1IDR, and no more than 10 IDRs should be issued in any 30-day period. This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to. 04/23/01 symposium comments: Information requests that are related should be asked for together, and the time for response should be considered based on information requested. Neutral or support staff version.	Support staff version. Limiting the number of documents requested or questions asked to verify the facts of a transaction in any certain time period would prevent timely development of the audit issue and delay resolution of the audit. Requests for information should be issued considering all documents necessary to gain an understanding of an issue, with follow up requests issued as appropriate. Response periods to IDRs can be adjusted based on applicable circumstances as provided in (a)(6). 04/23/01 symposium comments: Response periods are discussed in (b)(5)(C), and (a)(6).
4.	(b)(5)(C)(3)	No language. Issue addressed by language in subsections (a)(3), (a)(4), and (a)(6).	<u><i>If the auditor has asked for information that neither the taxpayer nor taxpayer’s representative has in their possession, the time period to respond to that IDR shall be tolled so long as the taxpayer has made reasonable attempts to obtain the information from the third party holders of such information.</i></u>	If a reasonable effort has been made to obtain the information outside the taxpayer’s control, the 2-year timeframe should be tolled allowing for the information to be obtained. This comment was originally made to Reg. 19504 that was withdrawn. An inquiry as to the relevance of this comment to Reg. 19032 was not responded to. 04/23/01 symposium comments: None.	Support staff version as participant’s concern regarding obtaining information in a timely manner is addressed in subsections (a)(3), (a)(4), and (a)(6). Extensions of time should be considered on an as needed and relevant basis. If a reasonable effort has been made to obtain information outside the control of the taxpayer, staff will work with the taxpayer to consider alternative forms of documentation.

DRAFT
Proposed Regulation
Section 19032
(March 6, 2002)

§ 19032. Audit Procedures.

(a) General.

(1) The purpose of the audit is to *efficiently* determine the correct amount of tax based on an analysis of relevant tax statutes and regulations and case law as applied to the facts of the audit.

(2) In general, the audit of a tax return must be completed in sufficient time to permit the issuance of a notice of proposed deficiency assessment or proposed overpayment within the applicable statute of limitations. Consequently, audits must be completed within four years after the date the original tax return was filed unless a longer period for issuance of a notice of proposed assessment is provided for under the Revenue and Taxation Code, or the taxpayer consents to extend the period of assessment under Revenue and Taxation Code sections 19065, 19067, or 19308. To facilitate the timely and efficient completion of an audit within the above-referenced statutory timeframes, the taxpayer should have the expectation that the audit of the tax return would be conducted in a manner so that resolution of the audit will be achieved within a two-year period commencing with the date of “initial audit contact” as subsequently defined. This two-year guideline will not apply in the following circumstances:

(A) False or fraudulent tax returns. False or fraudulent tax returns are those filed where an activity or conduct as described under Revenue and Taxation Code section 19701 or 19705 has occurred.

(B) Audits that are delayed as a result of the taxpayer’s bankruptcy proceedings.

(C) Audits in which a demand for information letter citing the failure to furnish information penalty, Revenue and Taxation Code section 19133 has been sent to the taxpayer or the taxpayer’s representative.

(D) Audits involving proceedings concerning the enforcement or validity of a subpoena or subpoena duces tecum.

(E) There is a request for consideration of Revenue and Taxation Code section 25137 petition, *but only in relation to the effect of the petition request. The issuance of notices may be delayed pending the outcome of the petition request.*

(3) Taxpayer's Duty to Respond. A taxpayer, or the taxpayer's representative has the duty to make a timely ~~and complete~~ response to requests for information or documents by the Franchise Tax Board that are relevant and reasonable or provide an explanation as to why additional time is necessary to respond or state why the request is not relevant or reasonable.

The auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit.

(4) Duty of Franchise Tax Board Staff. Franchise Tax Board staff has the duty to:

(A) apply and administer the law in a reasonable, practical manner consistent with applicable federal and California law and the Statement of Principles of Tax Administration.

(B) take into account the materiality of an issue being audited as defined in subsection (a)(7) of this regulation.

(C) make relevant and reasonable information requests for the issues under examination as provided for in Revenue and Taxation Code section 19504:

1. The auditor shall explain the relevance or reasonableness of the request when asked to do so.
2. Requests for information are relevant if the requested information is germane to or applicable to the audit issue, and
3. The auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit.

(D) timely analyze information received or responses submitted and to request additional relevant information or inform the taxpayer of the potential audit determination.

(5) Duty to Maintain Records. Generally, it is the taxpayer who will be in possession or control of the necessary information, documents, books and records and who will have the knowledge regarding the circumstances of the relevant activities such that a determination of the correct tax can be made. The inability, or failure, of a taxpayer to supply requested relevant information in support of the tax return as filed may result in a Notice of Proposed Assessment being issued. A taxpayer has a duty to maintain relevant records and documents pursuant to normal accounting or regulatory rules and the rules set forth in the Revenue and Taxation Code or the Internal Revenue Code as applicable for California purposes. The

Franchise Tax Board recognizes that taxpayers are sometimes not able to respond to each and every request for data. The auditor should work with the taxpayer to resolve difficult information requests or any other problems in generating information document request responses.

(6) Application of Time Limits. The guidelines of this regulation ~~are not intended to be used to foreclose or limit a taxpayer's right to provide information in support of the tax return as filed or amended. They~~ The guidelines are intended to provide guidelines for an orderly process that leads to a quick conclusion to the audit ~~and are not to be used to foreclose or limit a taxpayer's right to provide information in support of the tax return as filed or amended.~~

(A) The Franchise Tax Board recognizes that some Information Document Requests, Audit Issue Presentation Sheets or Position Letters can be responded to in less than 30 days while other responses will require time in excess of 30 days. (See subsection (b)(5) of this regulation for definitions of referenced documents.) The auditor has discretion to take into account the taxpayer's facts and circumstances in establishing the original response time or to allow extensions of time to respond.

(B) The auditor shall take into account responses to Information Document Requests and Audit Issue Presentation Sheets received after the established date for a response, provided the audit of the taxable year has not been closed.

(C) The guidelines identified in this regulation do not supersede or have any bearing on the statute of limitations for issuing deficiencies or refunds as provided by the Revenue & Taxation Code. Failure to adhere to the guidelines of the regulation will have no effect on the validity of a notice of proposed assessment, offset, notice of proposed overpayment, or no change letter issued within the applicable statute of limitations period, or on any rights of the taxpayer.

(7) Materiality. Audit issues are based on the materiality of the potential adjustment and balanced with the statutory requirement to determine the correct amount of tax. If potential for an audit adjustment is likely, the issue should be pursued if the materiality of the potential adjustment warrants the audit resources necessary to audit the issue. Auditors will use judgment as to what constitutes materiality for purposes of this subsection as materiality is a facts and circumstances test. The auditor will discuss materiality at any time during the audit if so requested.

(8) This regulation shall be applicable for initial audit contacts made on or after January 1, 2002 the effective date of this regulation within the meaning of Government Code Section 11343.4.

(b) Audits.

(1) Type of Audit. The Franchise Tax Board staff will determine if the audit will be a field audit or a desk audit based on the complexity of the tax return and which type of audit will be more conducive to effective and efficient tax administration. The taxpayer may offer input on the determination of the type of audit for the Franchise Tax Board staff to consider.

(2) Field Audits.

(A) Definition of Field Audit. A “field audit” is an audit that takes place at the taxpayer’s residence, place of business or some other location that is not an office of the Franchise Tax Board. For field audits, “initial audit contact” as used in subsection (a)(2) of this regulation is defined as the date of the first meeting between the taxpayer and/or the taxpayer’s representative and a member of the Franchise Tax Board audit staff. Generally, the Franchise Tax Board staff should first contact the taxpayer within two years of the date on which the tax return is filed.

(B) Location of Field Audit. A field audit will generally take place at the location where the taxpayer’s original books, records, and source documents pertinent to the audit are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer’s principal place of business. Field audits can be moved to a Franchise Tax Board office, or the taxpayer’s representative’s office, if the taxpayer (or the taxpayer’s representative) does not have the appropriate work area available or the taxpayer or the taxpayer’s representative does not have time available for the audit to be conducted at their location, or as circumstances of the taxpayer warrant.

(C) Site Visitations. Regardless of where the audit takes place, the Franchise Tax Board staff may visit the taxpayer’s place of business or residence to establish facts that can only be established by direct visit, such as inventory or asset verification. The Franchise Tax Board staff generally will visit for these purposes on a normal workday of the Franchise Tax Board during the Franchise Tax Board’s normal duty hours.

(D) Requests by Taxpayers to Change Place of Audit. The Franchise Tax Board staff will consider, on a case-by-case basis, written requests by taxpayers or their representatives to change the place that the Franchise Tax Board has set for an audit. Reasonable requests to move an audit to another of the taxpayer’s offices or to the taxpayer’s-representative’s office will be granted unless doing so would impose an unreasonable burden to the Franchise Tax Board staff or significantly interrupt the audit schedule.

If the taxpayer requests that the audit be conducted at a Franchise Tax Board office, or the taxpayer's-representative's office, it is the taxpayer's responsibility to deliver all books and records necessary for the audit.

(3) Definition of Desk Audit. A “desk audit” is an audit conducted primarily through mailed correspondence. For desk audits, “initial audit contact” as used in subsection (a)(2) of this regulation is defined as the date of the first letter to the taxpayer regarding the audit. Generally, the Franchise Tax Board staff should first contact the taxpayer within two years of the date on which the tax return is filed.

(4) Time of the Audit. It is reasonable for the Franchise Tax Board to schedule the day or days of the audit during a normally scheduled workday or workdays of the Franchise Tax Board, during the Franchise Tax Board's normal business hours. It is reasonable for the Franchise Tax Board to schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of particular taxpayers or their representatives. However, the Franchise Tax Board will work with taxpayers or their representatives to try to minimize any adverse effects in scheduling the date and time of the audit.

(5) The following audit procedures may be used either in field or desk audits depending on the nature of the audit.

(A) Opening Conferences. Items to be discussed during the opening conference include, but are not limited to, estimated timeframes to complete the audit, the scheduling of future audit appointments, discussion of the scope of the audit, the taxpayer's record retention policy, status of federal audits, amended returns, any corrections to information reported on the return that the taxpayer has identified and wants the auditor to take into account, information document requests, and photocopying.

At the opening conference, or via mail if no opening conference is held, the auditor shall provide a written document stating the name and phone number of the audit supervisor and manager, and any designated issue specialists assigned to the audit.

(B) Audit Plan. A written audit plan may be drafted as appropriate, or if requested by the taxpayer, documenting key dates related to conducting the examination, identifying key points of the examination, or identifying other items discussed during the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative. The audit plan is considered a guideline for conducting the examination and can be amended throughout the audit process as circumstances warrant.

(C) Information Document Request (IDR). The Franchise Tax Board may provide a taxpayer an Information Document Request (IDR) requesting single or multiple documents. As a general rule, response times shall be determined

on an IDR by IDR basis with a maximum response time of 30 days from the date the IDR was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.

1. As a general rule, where a reply by the auditor is appropriate or the auditor needs additional information, the auditor will notify the taxpayer or the taxpayer's representative within 30 days of the auditor's receiving the response to the IDR. Notification is achieved by issuance of additional IDRs, an Audit Issue Presentation Sheet or Position Letter, or by a response indicating additional time is necessary to respond and providing a date for future contact.

2. Failure to provide a timely and complete response to a request from the Franchise Tax Board for additional information ~~and authorities may-might~~ result in the audit being determined by resolving questions of fact to which the requests relate against the taxpayer in addition to assessment of penalties as provided by Revenue and Taxation Code section 19133 for failure to furnish information upon demand. In addition, subpoenas may be issued as authorized by Revenue and Taxation Code section 19504 to obtain relevant information.

(D) Photocopying. The Franchise Tax Board has the authority pursuant to the provisions of Revenue and Taxation Code section 19504, to require either the submission of relevant photocopied documents, or that relevant information be made available for photocopying, scanning or other electronic reproduction at a specified time and place for the purposes of administering and verifying compliance with the tax laws. Photocopying is a benefit to both the Franchise Tax Board and the taxpayer as the photocopy provides objective evidence supporting a tax position and allows for expediting the audit.

(E) Audit Conference. Conferences should be held throughout the audit to review the status of IDRs or to discuss proposed adjustments and to ensure that the audit is on track to finish within the estimated completion time discussed during the opening conference.

(F) Audit Issue Presentation Sheet (AIPS). An Audit Issue Presentation Sheet (AIPS) may be used during the course of the audit as soon as the issue is completed to inform the taxpayer of proposed audit adjustments. If an AIPS is not provided, the taxpayer or the taxpayer's representative may request one. AIPS provide the facts, law, analysis and the auditor's tentative conclusion concerning a specific issue. The taxpayer will be asked to provide a response confirming or denying the correctness of the factual description of the issue and will be provided an opportunity to provide additional facts and documents or other authority to rebut the auditor's conclusion within a period not to

exceed 30 days from the date the AIPS was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.

(G) Closing Conference. Items discussed during the closing conference will generally include an explanation of the audit adjustments, the audit schedules, the review process and protest rights.

(H) Position Letter. At the close of an audit, the auditor may provide, or the taxpayer or the taxpayer's representative may request a position letter. The position letter will explain the facts relied on, relevant law, analysis and conclusions on all audit adjusted issues, or may refer to previous AIPS.

(1) Audit schedules, if applicable will be provided with the position letter.

(2) The taxpayer or the taxpayer's representative will be provided an opportunity to respond to the position letter within a period not to exceed 30 days from the date the closing letter was hand delivered to the taxpayer, or the taxpayer's representative by the auditor or the date mailed by the auditor or as otherwise provided for in subsection (a)(6)(A) of this regulation.

(3) If the taxpayer or the taxpayer's representative responds to the closing letter with additional facts or authorities for the auditor to consider, the auditor will issue a revised closing letter to take into account the additional facts or authorities.

(I) Copy of Audit File. If requested by the taxpayer or the taxpayer's representative, a copy of the audit file will be provided to the extent not prohibited by law or protected by privilege.

(c) The audit results may also be subject to additional review by Franchise Tax Board staff to ensure that the audit recommendations are consistent with Franchise Tax Board policies, practices, and procedures. Adjustments to the audit recommendation made by review staff will be communicated to the taxpayer or the taxpayer's representative by the auditor or reviewer. Franchise Tax Board staff will complete its review and notices will be issued within 90 days after the close of the audit.

(d) "Automated Audits" generally involve a routine application of well established law or address discrepancies in income or deductions as identified through matching state tax return information to federal tax return information and other income or expense information returns, including, but not limited to, wage payments shown on Form W-2, or interest payments shown on Form 1099. Automated audits may include a request for additional information from the taxpayer, such as a completed head of household audit letter, or may be completed without any additional information being requested from the taxpayer. In these cases, taxpayers will receive a Notice of Proposed Assessment proposing to assess additional tax and explaining the reasons for the proposed

assessment. Usually, these audits are not assigned to a specific auditor, but may be assigned to other technical staff members.

(e) Amended returns received after commencement of an audit. If one or more amended returns are filed after an audit of the original tax return has commenced, the audit of the amended return is distinct from the audit of the original tax return for purposes of the guidelines provided for in subsection (a)(2) of this regulation. The Franchise Tax Board will use the information developed during the audit of the original return to the extent possible to avoid duplicating prior audit activity.

(f) Federal Audit Adjustments.

(1) The California Revenue and Taxation Code and Internal Revenue Code contain reciprocal provisions permitting an exchange of information. Under these provisions, the Franchise Tax Board may receive a copy of a final federal determination from the Internal Revenue Service. If notification of the final federal determination is received during the audit of the original tax return, adjustments proposed as a result of the federal audit may be incorporated into an ongoing audit. If the audit of the original tax return has been completed, separate notices will be issued reflecting the federal adjustments.

(2) The guidelines described in subsection (a)(2) of this regulation do not supersede or have any bearing on the statute of limitations as provided by the Revenue and Taxation Code to issue assessments or refunds based on final federal determination.

Audit Regulation Symposium
April 23, 2001
Summary

Ed Campion and Jeanne Harriman of the Audit Division and Bruce Langston of the Legal Division were the moderators. Ed Campion opened the symposium discussing the history of the regulation including the regulation calendar that was adopted at the Franchise Tax Board September 19, 2000 meeting and the prior symposium of December 1, 2001.

Jeanne Harriman discussed the future regulation process. We will be doing an update of the audit regulation during the May 2 Franchise Tax Board meeting. We will be prepared to present the revised regulation and matrix to the Franchise Tax Board at the first meeting after May 31, 2001 in order to seek direction on how to proceed.

Bruce Langston informed the participants that our role was to hear their comments and to provide any background information concerning the regulation.

The format of the symposium was to go over the regulation and matrix section by section. General comments were to be held in reserve until the detail was completed. The matrix, as requested by the Franchise Tax Board, discloses the staff version of the regulation, an alternative version offered by a participant, the participant's reason for the alternative regulation language and staff's response to the alternative language.

The following paragraphs refer to Item numbers as used in the matrix that was published with the audit regulation on March 15th on the department's web site:

Item 1. Based on a participant's comment staff agreed to add the word "efficiently" to subdivision (a)(1). The participant also wanted to change the language from "the purpose of the audit is to efficiently determine a correct amount of tax" to "a fair amount of tax." The participant's rationale was that it is sometimes difficult to determine the correct amount of tax. Staff opposed this change on the grounds that it is inconsistent with R&TC Section 19032 that provides in part that the Franchise Tax board will determine the correct amount of tax. Senator Burton has introduced SB 445 to define the general rule of any proceeding before the Franchise Tax Board that is to determine the correct amount of tax.

The symposium participants agreed with the addition of "efficiently" but offered no comment on "fair amount of tax."

Item 2. Subdivision (a)(2) provides the general rule that the statute of limitations controls how long we have to audit the tax return. There should be an expectation that the audit will be completed within two years. Subdivision (a)(2)(A) - (E) provides exceptions to the expectation that the audit will be completed in two years.

A participant suggested (a)(2)(C) be stricken. This section provides that if the auditor issues a demand letter citing the failure to furnish information penalty the two-year goal to complete the

audit is not applicable. One of the participant's concerns was that it would encourage auditors to use the penalty to avoid the two-year goal.

It is staff's opinion that the completion of an audit of a large multi-national corporation within two years will only occur if the auditor and the taxpayer operate as a team in a cooperative fashion. The threat of the failure to furnish information penalty only occurs after the taxpayer has twice been requested to provide the same information. The 3rd request includes the reference to the failure to furnish information penalty.

Some of the symposium participants were uncomfortable with the provision again with the concern that auditors would use it to avoid the two-year goal, versus the appropriate use of addressing the taxpayer's failure to provide information. Staff incorporated this comment to protect those taxpayers that failed to comply with early requests for information, but subsequently began providing the information. If cooperation and progressing of the audit were noted at the two year benchmark, the audit should continue and not be closed solely because the regulation guidelines so provide. Participants were asked how we could address the situation if this language is stricken Do the participant's want the audit staff to close the audit within the two year goal, or continue on with the audit? The participant's stated no to early closing, but offered no alternative language for this provision.

Staff also pointed out that the taxpayer has recourse through the auditor's supervisor, management and the Taxpayer's Advocate Office if the taxpayer believes the auditor is using the penalty inappropriately.

Item 3. Another exception to the two-year goal was where the taxpayer or the staff pursues a section 25137 petition which requires final approval by the Franchise Tax Board. Subdivision (a)(2)(E) was modified to state that we will attempt to complete the audit within two years although the petition and possible notices may be issued outside of the two-year time goal. Symposium participants made no comment on this item.

Item 4. Subdivision (a)(3) concerns the taxpayer's duty to respond. Staff had modified the original regulation to delete "and complete" and added the taxpayer could provide an explanation of why additional time to respond is necessary. A participant requested that "relevant" be replaced with "reasonable." Staff's response was that our information request should be relevant and reasonable to the issue being audited. Staff further noted that at times auditors do not know what information is available or possible alternatives and taxpayers are encouraged to work with audit staff to ensure that information requested is reasonable.. The taxpayer may be in the best position to offer alternative sources of information. Staff agreed that a taxpayer response to an information request explaining that the request is unreasonable, why it is unreasonable and offering alternatives to document the facts of the issue being examined is an appropriate and acceptable response. Symposium participants suggested an amendment to the regulation to reflect the above discussion.

Items 5, 6 and 7 concern the Duty of the Franchise Tax Board. Item 5 describes the staff's agreed revised subdivision based on participant's comments noted in Items 6 and 7. Item 6 refers to a participant's comment to change "relevant" to "reasonable." Staff and symposium participants agreed that the regulation should contain two separate tests for information requests – they should

be both relevant and reasonable. Symposium participants suggested that the "reasonable" test be more clearly articulated in the regulation.

Item 7 concerns the time to respond to the Information Document Requests (IDR). The participant wanted the response time changed from 30 days to 90 days. Staff replied that regulation had been modified to state that the general rule is 30 days with auditor discretion to allow for additional time. Symposium participants appeared to be receptive to the 30 day general response period for addressing each IDR, but further noted the appropriate time frame could differ for each IDR, shorter or greater than a 30 day response period.

Item 8 concerns the Duty to Maintain Records. The subdivision was initially modified to provide protection for large corporations in relation to IDRs. Further amendments provided that a Notice of Proposed Assessment (NPA) would not be issued in every situation where failure to provide information was noted. Staff felt that the protection sought for large corporations was appropriate for all taxpayers, thus suggested alternative language protecting all taxpayers. Further, the comment related to the issuance of the NPA was repetitive to text already incorporated in the regulation. . After the matrix was placed on the web the participant replied to staff that they were withdrawing both comments as we had addressed their concerns with our revised language. A symposium participant suggested that "generally" be added to the beginning of the subdivision.

Item 9 is a change to the Application of Time Limits subdivision (a)(6) based on comments received from the December 1, 2001 symposium. The change allow auditor discretion based on facts and circumstances to allow addition time to respond and that the auditor must take into account responses received after the response time if the auditor has the audit under their control. The symposium participants had no comment.

Item 10 was a participant's suggestion that there be an automatic tolling of the response time to 180 days due to illness, injury or death of the taxpayer or the taxpayer's employee who is handling the audit or if there is a catastrophic event such as an earthquake, act of war, etc. Staff believed that this section was not needed as hopefully the auditor has enough common sense to use their discretion to allow additional response times. It was pointed out that state law automatically tolls all activity, collections, audit, etc. if there is a catastrophic event. The symposium participants had no comment.

Item 11 is a new subdivision concerning materiality of audit issues. A participant made the suggestion that the taxpayer's cost be factored in the materiality scale. Staff oppose this primarily as it would lead to inconsistent standards between different taxpayers and could reward taxpayers that maintained inadequate record keeping systems, thus, making it more costly to retrieve information. Staff used the example of two taxpayers who claimed the Manufacturer's Investment Credit (MIC). One taxpayer before they filed their tax return listed all of the equipment that qualified for the credit on a spreadsheet that included identification of the equipment, cost, sales tax etc. The taxpayer pulled the related invoices and had all of the information organized in a file. The second taxpayer took the capital acquisition budget of the corporation times six percent but did not detail the credit documents at the time of filing. It would cost the second taxpayer more at audit then the first taxpayer to substantiate their credit.

One symposium participant suggested language that would increase the materiality threshold as the auditor got closer to the two-year goal. It was requested that he submit regulation language to this effect.

Items 12 and 13 concern the effective date of the regulation. In item 13, a participant suggested retroactive adoption of the regulation. Staff is opposed to the retroactive application of the regulation due to the negative impacts that could occur for taxpayers as well as audit staff as the initial rules supporting the audit engagement would change during the course of the audit.

In item 12, a participant suggested adoption of the regulation for taxable years ending on or after December 31, 2001. Under this provision, the regulation would not take mandatory effect until audits are began on 2001 tax years (generally filed until October 15, 2002 for large corporations) which generally will not start until 2004. Most of the symposium participants preferred an earlier effective date.

Item 14 concerns the type of audit, field versus desk audit. A participant requested that the subdivision be changed that along with the taxpayer FTB staff will decide the type of audit. Staff opposes this alternative as Franchise Tax Board staff must retain the right of final determination for the type of audit to effectively use resources and efficiently conduct audits from the taxpayers' and staffs' perspective. subdivision (b)(2)(D) provides that we will consider the taxpayer's request to change the location of the audit. One symposium participant expressed the concern that the taxpayer wants to be listened to. Staff agreed and stated that there are examples of where audits have started at desk or in the RAR unit and have been transferred to the field at the taxpayer's request. Participants' suggested taxpayer input be included by stronger reference in the regulation.

Item 15 There were no public comments.

Item 16 is in regard to Requests by Taxpayers to Change Place of Audit. A participant requested the addition that "generally reasonable requests to change the location of the audit will be granted. Staff opposes the change as in is more of a facts and circumstances test than a general rule. A symposium participant suggested that taxpayer request should carry great weight and that we do not have the legal authority to deny a request to transfer. Further, taxpayer's duty to provide records is to any feasible location, not just the FTB office or location audit staff dictates.

Item 17 was a staff change. No symposium participant comment.

Item 18 concerns the opening conference. A participant suggested mandatory use of an audit plan and if the taxpayer and the auditor disagree with the audit plan then the Franchise Tax board would resolve the issue. Staff pointed out that this is a regulation of general application. An audit plan is a useful tool in some audits but inefficient in many audits such as automated audits, RAR and desk audit. Having the Franchise Tax Board resolve the audit plan would delay the completion of the audit, and have a chilling effect on the relationship between the auditor and the taxpayer. Two symposium participants did not support the proposal wherein the audit plan could be appealed to the Franchise Tax Board, but suggested only that the taxpayer be allowed to request a written audit plan if they so desired. Audit plan should also reference any staff members who are involved in the audit.

Item 19 also concerns the opening conference. It requires an audit plan and prohibits the addition of new issues unless there is fraud. Staff opposes the limitation of additional issues as the tax return is a summary of many transactions. More audit issues are discovered by reviewing the underlying tax return workpapers than from reviewing the tax return. The limitation is contrary to R&TC Section 19032 in that the Franchise Tax is to determine the correct amount of tax. Symposium participants offered no comment.

Items 20 and 21 concern Information document Request (IDR). Both participant comments requested additional time to respond, one from 30 days to 90 days and the other to change "maximum 30 days" to "minimum 30 days." Staff pointed out that the direction in the Multistate Audit Bureau was to limit each request to one question in order to better track the request. Some IDR's are routine and can be turned around in a few hours or days, other requests takes weeks to respond. Staff believes that it is best if the department uses the general rule of 30 days with the auditor having the discretion for other timeframes. The department cannot complete the audit in two years if every IDR has a 90 day response time. Symposium participants offered no comment.

Items 22 and 23 limit the number of IDR's the department can issue, the timeframe to respond if several IDR's are issued and item 23 limits what the taxpayer can be requested to provide. Staff opposes these suggestions as they are contrary to the provisions of R&TC Section 19032 that provide the department is to determine the correct amount of tax. No direct comments were given on this alternative, but indirect discussion with symposium participants related to the relevance of the IDR, materiality and reasonableness. One participant suggested that the department make greater use of e-mail. Another participant brought up a concern about our requests for information that the taxpayer is unable to respond to as a matter of law without a subpoena from us (Financial Privacy Act). Staff provided that we need to be reasonable in our requests and we should work with the taxpayer in this situation. We felt this was not appropriately raised as part of this regulation process but would have to be solved by statutory change.

Item 24 concerns subdivision (b)(5)(B)(1) in which the general rule is that the auditor should reply to the taxpayer within 30 days of receipt of information. A participant wanted to add that if the auditor does not get back to the taxpayer within 30 days the taxpayer can assume that the response was adequate. Staff's concern is that this may prohibit factual development contrary to R&TC Section 19032. There was no public comment at the symposium.

Item 25 was a staff change in that a failure to furnish information penalty may be assessed for failure to provide additional information or authorities. "Authorities" was stricken as inconsistent with R&TC Section 19133. Symposium participants indicated agreement.

Item 26 is a participant's suggestion that the response time for IDR's be tolled if the taxpayer does not control the information so long as the taxpayer has made reasonable attempts to request the information. Staff disagrees as this should fall within the facts and circumstances audit discretion to allow additional time or for the taxpayer to provide alternative sources of information. The symposium participants offered no comment.

Item 27 is a staff change due to the December 1, 2000 symposium to allow the taxpayer to request an Audit Issue Presentation Sheet (AIPS). The description of the AIPS was changed to add that it will include an analysis and the auditor's tentative conclusion. A symposium participant's inquired into our ability to move an issue forward to settlement or appeals versus moving the entire tax year forward. Federal tax procedures allow for this. At this time, the California tax administrative processes does not allow for the advancement of a single issue, but requires resolution of the tax year.

Item 28 and 29 are participant's recommended changes to the timeframe to respond to AIPS. Staff believes this issued is already covered in subdivision (a)(6). The symposium participants offered no comment.

Item 30 alternative language requires a position letter and allows the taxpayer 90 days to respond to the position letter. A position letter is not a useful tool in all audits as the NPA serves to inform the taxpayer that their tax liability has been adjusted in regards to automated audits, adjustments based on RAR's or statutory adjustments. A symposium participant requested that we incorporate language that allows for the taxpayer to request a position letter if one is not issued. Staff recommends that the general rule for responses remain at 30 days with auditor discretion as provided in (a)(6). Symposium participants discussed the issue of whether reference to the closing letter on the NPA was sufficient notice the taxpayer of the grounds of the NPA, or does the NPA have to have a more detailed explanation. This legal argument is outside the scope of this regulation.

Item 31 addresses a participant's suggested change to the regulation that provides for a complete copy of the audit workpapers to be provided to the taxpayer at the close of the audit and to strike the reference that information protected by privilege would not be provided. Staff informed the symposium participants that the individual who offered the language agreed to modify the change to only when the taxpayer requests a copy. Symposium participants seemed more concerned that the practice of the department is over use privileges or to include information not protected by privilege. The symposium participants did not seem to take issue with the regulation language but more the department's practices. Staff discussed that this same language is in the draft protest regulation.

Staff opened the discussion to general comments. The following general comments were made:

1. A concern was expressed that adjustments are made to the field audit schedules by the reviewer and not explained to the taxpayer. Staff was asked why this is not covered in the regulation. Staff responded that subdivision c provides that the taxpayer will be informed of any change made by central office review. A participant recommended that the communication of the change be in writing.

2. A question was asked about the relationship of the department's Town Hall meetings and the regulation. Staff responded that the purpose of the Town Hall meetings was to get feedback from the public of our specific audit practices. That feedback will be used for training and manual revisions. A participant suggested that the department place the revised manuals on the web as a draft and ask for public comment before finalizing them.

Three symposium participants provided hand written comments at the conclusion of the symposium to take into account.

SUMMARY DISCUSSION OF AUDIT REGULATION

SYMPOSIUM

DECEMBER 1, 2000

A brief overview of the purpose of the meeting was discussed and Mr. Jon Sperring, Tax Counsel to Board Member Dean Andal, acknowledged the withdrawal of the initial draft of the audit regulation published on September 25, 2000, under cover of FTB Notice 2000-7. Mr. Sperring suggested proceeding with staff's proposed draft as the starting point for the symposium discussion. Ed Campion, Hearing Officer, reviewed staff's draft audit regulation, which contains audit practices currently employed by audit staff.

Is a Regulation Necessary?

There was consensus among symposium participants that some form of guidance and publication of the department's audit practices is appropriate and necessary. Key to consensus was a requirement that public comment be allowed for and considered as part of the publication process. Considerable discussion focused on potential methods of publication, the relevant strengths and weaknesses of each method, and the need to first determine the concepts and elements of departmental audit practices before determining the best method of publication.

Symposium participants expressed their belief that the department needed to change the way it conducts audits—not simply increase the number of audit staff members or impose stricter timeframes—if it is to meet the goal of making the audit process less intrusive to taxpayers and able to be completed in a timely manner. Many symposium participants expressed an interest in continuing discussions relating to the audit process.

What Elements Should Be Incorporated Into an Audit Standards and Practices Document?

Timeframes: Significant concerns were expressed regarding the statement of a time period for completion of an examination other than the general statutes of limitations, or a timeframe that was not subject to extension based on normal discretionary standards.

Concerns were also noted regarding the maximum 30-day reply or rebuttal period for Information Document Requests (IDR), Audit Issue Presentation Sheets (AIPS), and position letters. The majority of participants expressed concern that the one or two weeks that it might take for them to receive the IDR, AIPS, or position letter would leave insufficient response time, particularly if a taxpayer is involved with audits from other states or tax agencies. Some participants felt that up to 90 days would be a more feasible timeframe for responding, but staff expressed concerns that allowing such a long response time would not allow for completion of the audit within the two-year time frame.

Concerns were also raised about the lack of reference in staff's proposal regarding what would occur if the taxpayer responded with information or a rebuttal after the response period had passed. It was suggested that language be advanced that specifically provided that information or responses received after the expiration of the stated time period would be considered in determining the results of the examination.

A final concern related to how the start of an audit would be defined for purposes of the timeframes. Staff's draft audit regulation establishes the beginning of an audit upon receipt of the contact letter, or upon the first field visit between the taxpayer and the auditor. Concerns were expressed regarding contacts and requests for information that constitute preliminary scoping of the tax return prior to the start of the audit, and the effect on the two-year audit timeframe. It was suggested that this type of contact be addressed in the audit regulation/publication.

Materiality: Several symposium participants raised concerns regarding the materiality of audit issues pursued by staff, and expressed their opinion that audit staff should pay closer attention to the bottom line tax effect and have the authority to discontinue pursuit of any audit issue identified as immaterial. Participants further suggested that the determination of materiality should be made considering the cost of the examination to the department and the taxpayer.

IDRs: Several symposium participants raised concerns regarding the IDRs issued by audit staff, including: lack of detail, too much detail, insufficient time to respond, irrelevant information requested, voluminous documentation requested, and immaterial issues being addressed. Also an issue was raised relating to IDRs for smaller corporations or individuals, which are typically provided in a letter format and are not numbered, making it difficult to organize and track multiple requests.

Audit Tools: Other audit tools suggested as a way to conduct a more efficient audit addressed the ability of the audit staff to enter into closing agreements or settle an issue. Legislation may be required.

FTB Staff Response

Staff favors adoption of a regulation of general application and publication of the department's "Best Audit Practices." This was also seen as an acceptable solution by a majority of symposium participants. Concerns about obtaining public comment in drafting the publication can be resolved with FTB adoption of a resolution directing staff to seek public comment prior to finalizing the initial audit practices publication and prior to any future revisions.

FTB staff continue to be committed to resolving examinations within a two-year period. However, staff is also committed to working with impacted parties to determine what does and does not make this two-year timeframe feasible before proceeding forward.