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Sampling Strategies in Sales Tax Audits: Selecting an Appropriate Methodology and Negotiating With Auditors

THURSDAY, JULY 23, 2020, 1:00-2:50 pm Eastern

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Sampling Strategies in Sales Tax Audits

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Jason McGlamery, Director – Audit Sampling
Ryan
jason.mcglamery@ryan.com

Jamie E. T. Szal, Attorney
Brann & Isaacson
jszal@brannlaw.com

Brad W. Tomlinson, Senior Manager
Zaino Hall & Farrin
btomlinson@zhftaxlaw.com

Today's Program

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Jamie Szal, Brann & Isaacson

PART I: PLANNING FOR AUDIT AND NEGOTIATING A SAMPLE

Planning

I. Sampling only realistic way to audit in today's world of big data

II. But auditors still in 20^{th} Century for 21^{st} Century data

   A. See Exhibit 8 – New York State request for data and information

III. Planning should be undertaken long before the audit takes place in order to produce the best results for your client/company

Planning

IV. Know the software and accounting records and systems, billing system, and sales records of your client

   A. Type of journals (sales, etc.)

   B. Chart of Accounts and G/L codes of relevance

   C. Type of ledgers (fixed assets/accounts payable)

   D. Extent of underlying records

   E. Records Retention

V. Understand the business, including customers and products/services sold

Planning

VI. Population Characteristics to Consider

A. Availability of supporting documents

1. Knowing what documentation is and isn’t available may assist in determining the appropriate sampling plan

B. Significant accounting changes and systems within audit period

C. Business model changes within audit period

1. New service lines
2. New cost centers and/or general ledger accounts
3. New business segments (mergers & acquisitions)

D. Range of invoice dollar amounts within population

Planning

VII. Sales: How should taxable sales be determined?

A. Sampling of invoices to determine state and local jurisdictions sales

B. First Step: Determining the population from which to sample

1. Invoices or billing records
2. Reach agreement with auditor re population from which to draw

C. Completeness Testing: Assuring a good population

1. Tying Sales Journals to G/L accounts
2. Tying sales to corporate income tax returns

Planning: Sales Tax Issues

D. Sourcing challenges for sales tax determination

1. TPP and Services: Separate sourcing issues
2. G/L Accounts not organized by state
3. Sales Journals don't identify TPP destination/benefit received for services
4. Invoices: Identify billing address but not always destination or benefit of services location
5. Many companies lack invoices but simply have billing data without address information

Planning: Sales Tax Issues

VIII. Use Tax: Determining Taxable Purchases and Tax Due

A. Expenses: Accounts Payable Ledger & Journals

B. Fixed Asset Register or Subledger

IX. Use Tax Challenges

A. Accrual entries

B. Control Accounts (Assets not put into service)

C. Determining location of use

D. General ledger accounts do not identify taxable expense or where expense incurred

E. Fixed Asset Register does not identify location of Asset

Planning: Sales Tax Issues

F. Determining Tax Paid and comparing to purchases, including accrued and paid by taxpayer

G. Determining the population from which to sample expenses

   1. G/L Accounts vs. Accounts payable
   2. Completeness testing: Assure auditor that it is the right population to test

H. Determining population for fixed asset purchases

   1. Date of Register and Disposals
   2. Completeness testing to tie purchases to total

Preparing for the Audit

I. Review state's website, CCH and other services for --

   A. Applicable laws, regulations, advisory opinions and cases
   B. Determine law regarding limitations on sampling
   C. Determine alternatives if you refuse to sign a sampling agreement
   D. Determine good periods for purposes of test periods

II. Review prior assessments/audits from any state as a roadmap to vulnerability

Preparing for the Audit

III. Putting it all together: Devise a strategy to manage the audit and to respond to the state

A. Develop roles and responsibilities

B. Document, document and document

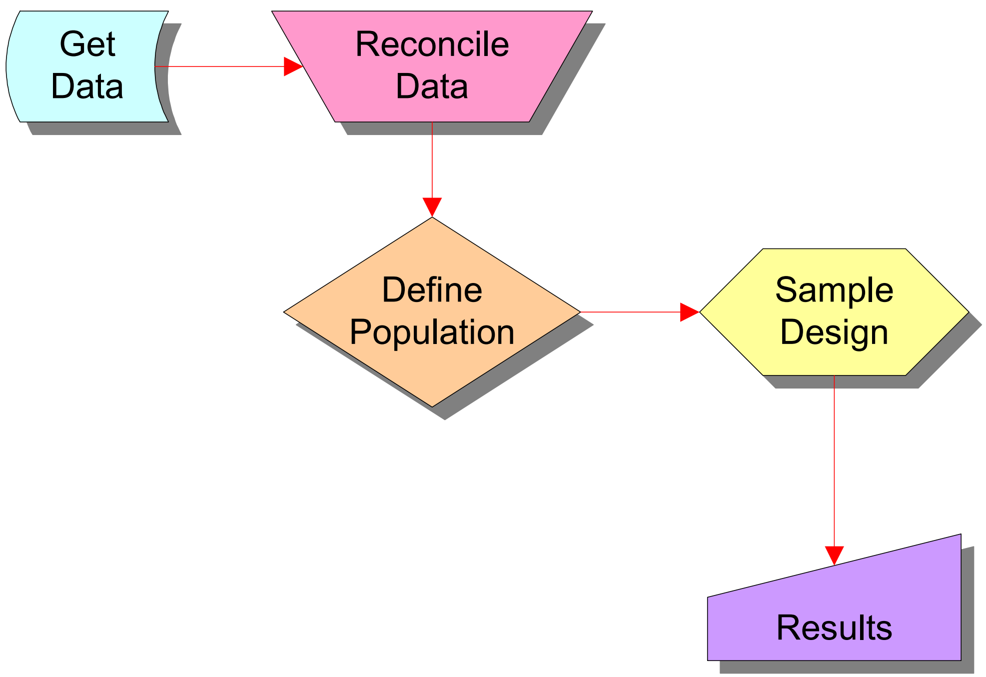
C. Understand data provided

D. Understand vulnerabilities

E. Be prepared to propose your own sample

The Life Cycle of Audit Data

Understand the life cycle of audit data:



The Life Cycle of Audit Data

I. Understand the life cycle of audit data

   A. Getting the data

      1. Work with your IT department and auditor in extracting necessary data for the sample audit

   B. Reconciling the data

      1. Reconciling AP to GL to ensure that transactions are complete and appropriate transactions are sitused to jurisdiction correctly

      2. Reconciling accruals to tax returns

The Life Cycle of Audit Data

I. Understand the life cycle of audit data (cont.)

   C. Defining the sampling population

      1. Work with auditor in developing the logic to derive the sampling population from the taxpayer file

      2. Perform additional reconciliations as needed to ensure that sampling population is complete and appropriate for the jurisdiction's audit

Message: Planning is the key; first three steps of life cycle require plenty of time (and patience!)

Planning the Sample Audit

II. Definition of the audit sampling population

A. Purchase audits

1. Selection of accounts of interest
2. Selection of groups by types of transactions for separate sampling populations (e.g., assets, expenses, taxed, non-taxed, procurement cards, inventory stores, leases, contracts with installment payments)

B. Sales audits

1. Taxed vs. non-taxed sales

Planning the Sample Audit

II. Definition of the audit sampling population (cont.)

   C. Other considerations for grouping transactions into separate sampling populations

      1. Accounting system changes
      2. Significant tax law changes
      3. Business changes (acquisitions, mergers, change in business structure)

Planning the Sample Audit

III. Treatment of special situations

A. Credits (i.e., negatively-valued transactions)

B. Tax only transactions

C. Duplicate transactions

D. Bad debt

E. Installment payments

F. Missing documentation

G. Overpayments

Jason McGlamery, Ryan

PART II: SAMPLING FUNDAMENTALS

Topics For This Section

I. Ten Commandments of audit sampling

II. Block sampling vs. statistical sampling

III. Stratified random sampling

IV. Statistical sampling terminology

V. Sample size determination

VI. Sampling population definition

VII. Refund claims based on samples

"Ten Commandments" Of Audit Sampling

1. Thou shall know thy data.
2. Thou shall know the rules, regulations, laws and court rulings concerning sampling for the tax jurisdiction.
3. Thou shall only include G/L codes that have indirect tax attributes in the audit population.
4. Thou shall never provide invoice data at kick-off meeting.
5. Thou shall always discuss procedures concerning "currently unavailable for review" invoices before beginning the audit.

“Ten Commandments” Of Audit Sampling

6. Thou shall always discuss how overpayments are treated.
7. Thou shall never immediately sign a jurisdiction’s sampling agreement (even for Ohio).
8. Thou shall not give the auditor data without first reviewing.
9. Thou shall always review the auditor’s calculations.
10. Thou shall establish an audit schedule with defined milestones and work review (keep the “wheels on”).

Block Sampling Methods

I. Block sampling applications
   A. Time periods (e.g., months within audit period)
   B. Store-days in retail sales audits
   C. Vendors (e.g., subset of vendors for auditing)
II. Randomization in block sampling
   A. Randomly selecting months or store-days
   B. Randomization is an insurance policy against bias in sampling.

Block Sampling Methods

III. Block sampling advantages
   A. Selection of records – often easier than random sampling
   B. Requires limited knowledge of statistical sampling methods
   C. Recent months can be selected, if missing documentation is an issue for older months in audit period

IV. Block sampling disadvantages
   A. No mathematical basis for measuring sampling risk
   B. No information on periods or store-days not sampled

Statistical Methods

I. Statistical sampling methods
   A. Simple random sampling
      1. Random sample taken from audit population
   B. Stratified random sampling
      1. Population is subdivided into groups called "strata"
      2. Transactions have similar properties within each group, but properties vary across groups
      3. A simple random sample is taken from each stratum
   C. Sequential sampling
      1. Select every k^{th} item ($k > 1$) in a list of items

Statistical Methods

II. Statistical sampling advantages

A. Efficient: Typically, a smaller sample size is required when compared with block sampling.

B. Produces measures of sampling risk

1. Achieved relative precision
2. Confidence interval
3. Confidence bound

Statistical Methods

III. Statistical sampling disadvantages

A. Requires knowledge of introductory statistics and sampling methods

B. Can be complicated, particularly if advanced estimation methods are used (e.g., regression estimators)

Stratified Random Sample Example

Stratified random sample with exclusion stratum, detail stratum and three sample strata:

Stratum Label	Lower Bound (value greater than)	Upper Bound (value less than or equal to)	Population Base Dollars	Population Base Items	Sample Base Dollars	Sample Base Items	Projection Factor ($ population per $ sample)	Tax Projection on Average Item (tax rate = 8.25%)	Percent Difference between Sample and Population Means
Group 1 - Expenses									
1A		0	$0.00	25					
1B	0	125	$500,000.00	12,000					
1C	125	1,000	$4,500,000.00	8,000	$135,000.00	250	33.33	$1,485.00	-4.00%
1D	1,000	25,000	$15,000,000.00	2,000	$1,900,000.00	250	7.89	$4,950.00	1.33%
1E	25,000	75,000	$25,000,000.00	625	$10,300,000.00	250	2.43	$8,250.00	3.00%
1F Detail	75,000	max	$15,000,000.00	150	$15,000,000.00	150	1.00		
Group 1 - Total			**$60,000,000.00**	**22,800**	**$27,335,000.00**	**900**			

Stratified Random Sample Example

I. Detail threshold set at $75,000
   A. Goal: Detail stratum contains at least 20% of population base dollars and maximum detail threshold of $100,000

II. Number of sample strata – three used in this plan
   A. Goal: Use between two and seven sample strata

III. Lower exclusion threshold set at $125
   A. Items not audited in exclusion stratum
   B. $500,000 x 8.25% x 10% (assumed error rate) = $4,125
   C. Goal: No more than 5% of population base dollars in lower exclusion stratum

Stratified Random Sample Example

IV. Projection factor (separate ratio estimation method)

   A. Population base dollars/sample base dollars
   B. Example: Stratum 1C: $4,500,000/$135,000 = 33.33
   C. Each $1 in tax error in sample projects to $33.33 in Stratum 1C population
   D. Goal: Maximum projection factor of 1,000 for any sample stratum

Stratified Random Sample Example

V. Tax projection on average item

   A. Sample average x projection factor x tax rate

   B. Example: Stratum 1C [$135,000/250] x 33.3333 x 8.25% = $1,485. This is expected tax error for each sampled item.

   C. Goal: $50,000 maximum value for this measure

VI. Percent difference between sample and population means

   A. Example: Stratum 1C [$540 - $562.50]/$562.50 x 100% = -4.00%

      1. Sample mean = $135,000/250 = $540

      2. Population mean = $4,500,000/8,000 = $562.50

   B. Goal: Variance between plus or minus 5%

Statistical Sampling Terminology

I. Relative precision
   A. Percentage difference between estimate of tax error and actual population tax error
   B. Common values in audit sampling:10%, 25%
II. Confidence level
   A. Confidence for which we want estimate to achieve stated relative precision
   B. Common values in audit sampling: 75%, 80%, 90%

Statistical Sampling Terminology

III. Typical statement: “We want estimate to be within 10% of the actual value in population with 90% confidence.”

   A. Interpretation: If the sample is repeatedly drawn many times, then 90% of the samples will produce an estimate within plus or minus 10% of the actual population value.

Sample Size Determination

I. Rational and reasonable cost/benefit analysis

   A. Benefit: The larger the sample, the better the estimation precision

   B. Cost: The larger the sample, the greater the auditing cost

   C. Must achieve balance between cost and benefit

Sample Size Determination

II. Fixed sample size

A. Texas: At least 100 per stratum for stratified sampling; at least 250 for simple random sampling

B. Stratified random sampling

1. Multistate Tax Commission: At least 200 per stratum, absolute minimum of 100
2. California: At least 300 per stratum with invoice as sampling unit
3. Many states use minimum of 200 or 250 per stratum

Sample Size Determination

III. Sample size determination formulas

A. Three inputs to formulas

1. Relative precision
2. Confidence level
3. Standard deviation of tax error (tax error = correct tax – actual tax paid)

Sample Size Determination

IV. Sample size determination formulas

B. Formulas frequently misused

1. Population standard deviation of tax errors unknown – no estimate until sample is audited
2. Common mistake: Standard deviation of invoice or line item amount used in place of standard deviation of tax errors

C. Preference: Fixed sample size, not sample size determined by formula

D. Expand sample if necessary, if audit work suggests sample not representative

Sampling Population Definition

I. Accounts of interest

   A. Mutually select accounts of interest with auditor

      1. Educate auditor on accounts that do not need to be audited

      2. Include accounts that may be in your favor (e.g., accounts containing potential overpayments of tax)

Sampling Population Definition

II. Taxed vs. non-taxed purchase transactions

A. Inclusion of tax paid and/or tax accrued transactions in population

1. Include these in managed audits or in audits for states that permit projection of overpayments
2. Georgia: In sample strata, projected overpayment cannot exceed projected underpayment
3. California: Ask auditor/computer audit specialist to develop sampling plan for accruals

Refund Claims Based On Samples

I. States permitting refund claims based on samples

   A. Texas: Statute 151.430

   B. Several states permit refund claims based on samples, provided the state is involved in development of the sampling plan and/or generating the sample (e.g., Alabama, California, Florida, Iowa, Kansas, Maryland, New York, Washington).

   C. States not permitting refund claims based on samples

      1. Pursue the issue with auditor to base refund on sample

      2. Matter of taxpayer equity and fairness

Refund Claims Based On Samples

II. Crafting a proposal for using a sample as basis for refund claim

   A. Texas: Follow guidelines in Texas *Sampling Manual*, which available on the Comptroller's Office Web site

   B. Other states

      1. Notify state of intention to file refund claim based on sample

      2. Seek advice on process for submitting claim

      3. Follow state's sampling guidelines in developing a block sample or a stratified sample

Jamie Szal, Brann & Isaacson

PART III: LEGAL ISSUES AND BACKGROUND

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Requirement to Disclose

I. Failure to provide data leads to jeopardy assessments
   A. Example: WAC458-20-254(5)
      1. Failure to disclose records bars taxpayer from questioning, in any court action or proceedings, the correctness of any assessment or taxes made by the department based upon any period for which such books, records, and invoices have not been disclosed.

Requirement to Disclose/Keep Records

I. If records are inadequate, states have more leeway to make wild estimates
   A. See e.g., *NY TB-ST-770(2011)*
      1. State also can impose penalties and interest for such failure
II. Similar provisions in other states
III. States are relying on similar statutory authorizations to make wild and large assessments

Authority to Sample

I. State Authority to Use Sampling –

A. Early court challenges to use of sampling

1. *Marine Midland Bank* – (NY Tax Appeals Tribunal 5/13/93)

B. States modified statutes granting authority to sample

C. Majority of states permit sampling without taxpayer consent even if books and records are adequate to make an exact assessment

1. Some states still require taxpayer consent: AR Code 26-18-305(a)(2)(B); PA Sales and Use Tax Bulletin 2013-01

2. Others that don't require consent mandate use of generally recognized and reliable sampling technique. *See*, *e.g.*, K.S.A. 79-3610

Authority to Sample

D. Many states permit use of sampling for claim for refund

1. FL Tax Information Publication No. 03A01-01 (1/22/03)
   (a) Records must be adequate and voluminous.
   (b) One of three methods
      i. Taxpayer request per the certified audit program
      ii. Attestation by CPA as to adequacy of sampling method used and results of sampling
      iii. Sampling method approved by Department
2. WAC 458-20-229
   (a) Only for “voluminous” records
   (b) Requires Department approval of sampling plan

Limitations on Sampling

I. Limitations/Comments

A. Some states require voluminous records – e.g. FL

B. Others require generally recognized and reliable sampling techniques but consent not necessary

1. Minn. Stats. § 270C.03(1)(3)
2. Taxpayer has the burden of showing by clear and convincing evidence that sampling method is not in accordance with generally recognized sampling techniques (*see e.g.*, Penn. Stats. §10003.21)
3. See *In the Matter of the Appeal of National Catastrophe Restoration, Inc.*, (KS Ct. Appeal; 2013)

Limitations/Comments on Sampling

C. MA authorizes only statistical sampling –

   1. M.G.L. c. 62C, § 24

      (a) Attempt to reach agreement, but if agreement not reached, Commissioner can use statistical sampling method that complies with Internal Revenue Code

   2. See e.g., *Circuit City Stores, Inc. v Commissioner of Revenue*, CCH ¶ 400-762 (MA Appellate Tax Board 2002)

D. Taxpayer must show error in sampling, even if block sampling used. *By Lo Oil Co. v. Department of Treasury*, CCH ¶ 401-156 (MI Ct. Appeals 2005)

Limitations/Comments on Sampling

E. Failure to produce records or develop alternative method means assessment will be upheld in case where taxpayer produced records for some but not all sales; remaining sales deemed all taxable. *Rhino Coat Surface Refinishing, Inv. v Division of Taxation*, CCH ¶ 401-852 (Tax Court of NJ 2014)

F. Based on statutory provision giving the Commissioner the authority to estimate tax due when taxpayer's records are inadequate, Court approves audit's use of indirect audit method (sales based on purchases) and not subject to challenge for failure to use generally accepted sampling techniques. *Conga Corp. v Commissioner of Revenue*, CCH ¶ 204-804 (MN Supreme Court 2015)

Written Consent to Sample

I. Auditor's request to sign sampling agreement: May the taxpayer refuse?

   A. Most states: No "penalty" if don't sign

   B. Ohio: Unless taxpayer signs consent to do statistical sample no credit is provided as part of the audit for incorrectly paid tax, but Taxpayer must file a separate claim for refund (see Exhibit 7 and OH Department of Taxation, "General Sales/Use Tax Refund Policy & Procedure, effective date of April 11, 2014); Ohio Admin 5703-29-03

   C. New York: If sign consent form, restricted in ability to challenge sampling methodology. Must prove auditor did not adhere to agreed to method in all respects.

Consequences of Signing a Consent to Sample Document

I. Consent to sampling plan: A <u>waiver</u> in most states

   A. See, e.g., *Shugarman Surgical Supply, Inc. v. Tracy,* OH Bd. Of Tax Appeals (signed consent waives errors in sampling even though agreement said that taxpayer did not waive right to appeal assessment)

      1. Use of block sample of 3 months

      2. Error rate projected for all sales in audit period

      3. Disproportionate taxation of sales

   B. *Prime Refrigeration, Inc. v. AZ Dept. of Revenue*, Arizona Board of Tax Appeals (April 7, 1998) (agreed non-statistical sampling approach waives any objections)

Consent to Sample

I. Sampling: The Plan

   A. Insist that sampling plan is put in writing

   B. Make sure sampling plan is accurate

   C. Sample design and how projected are key factors

II. Sampling: The Contract

   A. Resist signing agreement until and unless it is what you want

Consent to Sample

III. Sampling agreement
   A. Proposal from state
      1. Standard form that should be modified
      2. Call out and document issues
   B. Reserve rights re projections and other aspects of sample
   C. Sign only if agree with sample plan and language
IV. Document actions taken
   A. Failure puts taxpayer at handicap regarding sampling
V. Make sure auditor follows plan, including projections

Bradley Tomlinson, Zaino Hall & Farrin

PART IV: AUDITOR PERSPECTIVE FOR STATISTICAL SAMPLING

Statistical Sample Process

I. The computer assisted auditing brochure (if available) should be sent with the initial audit package.
   A. The statistical sample should be introduced at the earliest possible time
II. Discuss the option with taxpayer either prior to or during initial conference.
III. Supply the taxpayer with a sample of an agreement.
IV. Develop the initial range of accounts to be included in electronic file
   A. The taxpayer should have input

Statistical Sample Process

V. Perform data screening and verify against another source to insure completeness and usability of download data

VI. Refine the target population by removing non-relevant accounts or items based on downloaded period and needs

VII. Identify and isolate segments of population to be handled outside of the statistical sample

   A. Procurement cards, brokered natural gas, leases, store inventory withdrawals, journal entries, etc.

VIII. Verify and review the target population with audit manager

IX. Verify and review the target population with taxpayer

Statistical Sample Process

X. Submit the target population to the computer assisted audit group to create the sample design

XI. A recommended statistical sample will be designed and a summary detailing the sample will be returned

XII. Review the recommended sample design with the taxpayer and determine the seed number to be used in generating the randomly selected items

XIII. Draft the agreement and send through the audit manager to the computer assisted audit group for review and approval

Statistical Sample Process

XIV. Finalize the agreement with the taxpayer (signatures) and send an electronic copy of the finalized agreement to the computer assisted audit group

   A. The pull list will be generated and returned

XV. Set up the file to properly document findings

   A. Include fields the taxpayer needs

XVI. Evaluate primary records for the selected items and record determinations

XVII. Review findings with taxpayer and adjust if necessary

XVIII. Import findings into the audit application

Statistical Sample Process

XV. Set up the file to properly document findings
    A. Include fields the taxpayer needs

XVI. Evaluate primary records for the selected items and record determinations

XVII. Review findings with taxpayer and adjust if necessary

XVIII. Import findings into the audit application

Other Items You Should Know

- Minimum sample size
- Desired precision and confidence
- Projection method(s)
- Credit procedures
- Minimum number of errors
- Adjusting for errors after the review

Jamie Szal, Brann & Isaacson
Jason McGlamery, Ryan, LLC
Bradley Tomlinson, Zaino Hall & Farrin

PART V: AVOIDING THE "WHEELS OFF" SAMPLE AUDIT

Avoiding the "Wheels Off" Sample Audit

Part 1: The Do's and Don'ts of Audit Sampling

A. Déjà vu: The "Ten Commandments" of audit sampling and effective planning strategies

Part 2: Reasons Why the Wheels Come Off

A. Common causes for sample audits going badly

Part 3: Sample Audits That Went Badly

A. The war stories and what we can learn from them as avoidance strategies

The "Do's" of Audit Sampling

I. Do treat the auditor with professional respect
II. Do take a proactive role in managing the audit
III. Do know your data well prior to the audit
IV. Do be prepared to discuss data and sampling issues with the auditor
V. Do negotiate key issues with auditor prior to starting the audit
VI. Do review auditor's proposed sampling plan and sampling procedures

The "Do's" of Audit Sampling

VII. Do keep all discussions, deliberations and negotiations at a professional level

VIII. Mea culpa: Do accept responsibility for problems or issues that you created or for which you share responsibility with the auditor

IX. Do respond promptly to auditor requests, and expect the same from auditor in responding to your requests and questions

The "Don'ts" of Audit Sampling

I. Don't allow auditor to have unrestricted access to your facility
II. Don't allow auditor access to any individual other than the designated contact person.
III. Don't take a reactive position with the management of the audit
IV. Don't offer any accounting/finance information not pertinent to the audit

Reasons Why the Wheels Come Off

I. Many sampling methodologies fall short of accepted standards
   A. Heavy reliance on non-statistical block sampling
   B. Lack of training or understanding on auditor’s part
   C. Disconnect between field auditors and sampling specialists
   D. Lack of understanding by taxpayers of methodology
   E. Lack of understanding by taxpayers of data provided
II. Sampling deficiencies cause gross distortions

Examples of the Wheels Coming Off

I. Florida "new methodology" for re-situsing of communications services to local jurisdictions
   A. Use of simple average of local addresses without weighting by dollar amounts and offsets for overpayments

Examples of the Wheels Coming Off

II. Population file not reconciled

A. Taxpayer had three months of sales data missing and another three months of sales data duplicated.

1. Problem not recognized until auditing of records was well under way

B. Taxpayer used Excel to extract monthly purchase data.

1. Data overlapped at beginning and ending of each month with the previous month and the following month.

Examples of the Wheels Coming Off

II. Population file not reconciled (Cont.)

C. Texas auditor repeatedly requested data for a sales and use tax audit, but taxpayer could not provide usable electronic data.

1. Data provided did not reconcile to financial statements.
2. Taxpayer claimed IT department could not provide complete data, because the firm was acquired during audit period.
3. Texas issued a Notification of Estimation Procedures for State Tax Audit.

Examples of the Wheels Coming Off

III. But I want to keep the zero items in the population!

   A. There is a misconception that the more non-errors you have, the better the results

   B. How can more errors be better?

Examples of the Wheels Coming Off

IV. Taxpayer supplied multiple lines of sales data, one showing state tax and one showing local tax, but taxpayer did not appreciate it was the same sales, but different taxes assessed.

   A. Audit assessed both sets of sales.

   B. Uncovered once taxpayer’s representative reviewed audit detail.

Examples of the Wheels Coming Off

V. Improperly designed sampling plan

A. Auditor's sampling plan did not follow state's audit sampling policies and procedures.

1. Taxpayer did not review sampling agreement and sampling plan during the planning phase of audit.

B. Procurement card transactions were commingled with other expense transactions.

1. Large P-card liability due to missing documentation

2. Failure to isolate P-card transactions in separate group for auditing

Examples of the Wheels Coming Off

VI. I don’t know why the records are duplicated, our system just does that!

  A. Verification of the data is possibly the most important step

  B. How do you fix it?

Examples of the Wheels Coming Off

VII. Taxpayer failed to provide sales data from sales journal that tied to state income tax returns

A. Audit assessed based on sales factor of state income tax returns

1. Some sales not taxable
2. Some sales not properly sourced to assessing state

Examples of the Wheels Coming Off

VIII. Improperly designed sampling plan (Cont.) – Actual auditor developed sampling plan in East Coast state:

Stratum Label	Lower Bound (real value greater than)	Upper Bound (real value less than or equal to)	Population Base Dollars	Population Base Items	Population Average	Sample Base Dollars (expected)	Sample Base Items	Sample Size as Percentage of Population Size)
Group 1 - Expenses								
1A	$10	$50	$250,000.00	6,000	$41.67	$12,500.00	300	5%
1B	$50	$100	$450,000.00	3,000	$150.00	$112,500.00	750	25%
1C	$100	$250	$500,000.00	1,500	$333.33	$400,000.00	1,200	80%
1D	$250	$1,000	$600,000.00	500	$1,200.00	$570,000.00	475	95%
1E Detail	$1,000	max	$750,000.00	150	$5,000.00	$750,000.00	150	100%
Group 1 - Total			**$2,550,000.00**	**11,150**		**$1,845,000.00**	**2,875**	

Strafford

Examples of the Wheels Coming Off

IX. I am too busy to look at the file before I give it to you!

   A. Get the taxpayer's technical experts involved early in the process

   B. Garbage in, garbage out

Examples of the Wheels Coming Off

X. Taxpayer took network equipment exemption in Virginia

A. VA statute must measure non-exempt use, and taxpayer did not provide this information

B. State tax agency used industry average

C. At protest able to use current usage as proxy for usage during audit period

Examples of the Wheels Coming Off

XI. Specific audit sampling issues arising in sales and use tax audits

A. Population base dollar amount summed incorrectly, resulting in error in projected tax

B. Assessment scheduled in wrong exam

C. Interest computed incorrectly

<u>Message</u>: Check and double-check all computations performed in calculating assessment or refund

Examples of the Wheels Coming Off

XI. Specific audit sampling issues arising in sales and use tax audits (Cont.)

D. Auditor and taxpayer failed to identify detailed refund claims and exclude the associated transactions from the sampling population.

E. Auditor developed a one-month block sample for a 36-month audit of expenses, and then took a random sample of the expense transactions within that month.

F. Taxpayer used a sample to estimate the refund for types of transactions that must be detailed based on the state's policies and procedures (e.g., unclaimed property, fuel tax).

Examples of the Wheels Coming Off

XII. I don’t like the result, let’s start over!

A. It’s too late to turn back now!

B. Making adjustments at the later stages is very risky

C. If all else fails, start over!

Examples of the Wheels Coming Off

XIII. Auditor devised sampling plan that attempted to measure taxable expenses, fixed assets and taxable purchases per construction contracts on leased facilities

A. Auditor did not test population: Some assets in fixed assets were also part of leasehold improvements as part of construction contracts

Examples of the Wheels Coming Off

XVI. Determining taxable sales for a long audit period

A. Use of current measure to project for prior period without accounting for differences in types of products sold.

Examples of the Wheels Coming Off

XXII. Auditor determined the taxable percentage for fixed assets. Client also had a control account. Auditor applied taxable percentage to control account.

A. Duplicate assets in control account and in fixed assets

B. Differences in control assets – software – vs. all fixed assets

C. Taxable error rate did not take into account clearly not taxable assets

Reference Materials on Audit Sampling

1. Exhibit 1: FTA State Sampling Manual
2. Exhibit 2: FTA State Sampling Policies and Procedures Matrix
3. Exhibit 3: MTC/FTA Update of State Sampling Policies (2006)
4. Exhibit 4: Sampling Fundamentals Paper
5. Exhibit 5: California BOE Form 472 Sampling Agreement
6. Exhibit 6: ALEC Policy Statement on Refunds based on Samples
7. Exhibit 7: Ohio Sampling Agreement
8. Exhibit 8: New York State Request for Data and Information