



BUREAU OF AUDITS

Sales and Use Tax Manual



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INTRODUCTION

Department's Purpose

Funding Programs and services to benefit all Pennsylvanians.

Department's Mission

To fairly, efficiently, and accurately administer Pennsylvania tax and Lottery programs.

Department's Vision

To be an innovative, customer-focused, and employee-centered agency.

Department's Values

- We act with integrity
- We are inclusive
- We are connected
- We are service-oriented
- We are adaptable
- We are continuously learning

Audit's Mission

To ensure and stimulate compliance with Pennsylvania tax laws and policies through an equitable, efficient, and informative audit process.

Audit Guide

The primary objective of this manual is to provide instructions on the performance of a Pennsylvania sales, use and hotel occupancy tax compliance audit. In addition, minimum requirements for taxpayers with exposure to the employer withholding tax, personal income tax, public transportation assistance fund taxes and fees and vehicle rental tax are outlined. Instructions are based on current state tax statutes, Department regulations and policies, court cases, previous audits, appeal decisions, and general accounting and auditing principles.

This manual is intended as guidance to the audit staff. Auditing methods and techniques suggested in the manual may not be necessary or applicable for every audit. This manual is not authoritative and may neither be cited to support an audit position nor relied on by the taxpayer.

This manual and its auditing procedures will be continuously evolving as it is impacted by changes in tax statutes, regulations, court cases, Departmental policies, and Information Technology (IT) resources.

Quality Control

This manual is designed for use by Bureau personnel in maintaining quality control. Audit reports must be in compliance with the requirements outlined herein as well as any additional regional instructions prior to final approval and the issuing of an assessment. This process will help ensure the audit reports prepared by the Bureau throughout the state are accurate, consistent, professional, and sustainable through the appeal process.

CHAPTER I- TAX OVERVIEW

Entities that have nexus with Pennsylvania are required to charge, collect, report, and remit various taxes on certain sales transactions. These taxes include the following:

- Sales and Use Tax (SLS)
- Hotel Occupancy Tax (HOT)
- Public Transportation Assistance Taxes and Fees (PTA)
- Vehicle Rental Tax (VRT)

In addition, Pennsylvania employers are responsible for the withholding of Pennsylvania personal income tax from employee wages subject to the tax. The personal income withheld from employees is also considered a business trust fund tax.

Nexus

“Nexus” is the term used to describe when an entity (business or individual) conducts sufficient activities within the taxing jurisdiction (Pennsylvania) to create an obligation to collect and remit its taxes. There are three types of nexus situations which can trigger an entity’s obligation to charge, collect, and remit the previously mentioned taxes:

- Physical Nexus
- Marketplace Nexus
- Economic Nexus

Each type of nexus is described below. Any questions relating to nexus determinations must be reviewed with the Division. The regional staff should consult with the Division to identify the questionnaires and additional information the taxpayer needs to provide.

Physical Nexus

An entity has nexus if it conducts activities within Pennsylvania that constitute maintaining a place of business under 72 P.S. § 7201(b). One or more of the following activities conducted within the Commonwealth constitutes maintaining a place of business in Pennsylvania:

- An entity owns, rents, leases, maintains, or has the right to use tangible personal or real property that is permanently or temporarily physically located in the Commonwealth.
- An entity’s employees own, rents, leases, uses, or maintains an office, distribution house, sales warehouse, service enterprise or other place of business in Pennsylvania.
- An entity has goods delivered to Pennsylvania in vehicles the entity owns, rents, leases, uses, or maintains or has goods delivered by a related party acting as a representative of the entity.

- An entity's agents, representatives, independent contractors, brokers, or others, acting on its behalf, own, rent lease, use, or maintain an office distribution house, sales house, warehouse, service enterprise or other place of business in Pennsylvania and this property is used in the representation of the entity in Pennsylvania.
- An entity's agents, representatives, independent contractors, brokers, or others acting on behalf of an entity, are regularly and systematically present in Pennsylvania conducting activities to establish or maintain the market for the entity whether or not these individuals or organizations reside in Pennsylvania.
- Activities that establish or maintain the market in the Commonwealth. These activities include soliciting sales; servicing property sold or to be sold; collection on accounts related to the sale of tangible personal property or services; delivering property sold to customers; installation at or after shipment or delivery; conducting training for employees, agents, customers, or potential customers; providing customer support; providing consultation services or soliciting, negotiating, or entering franchising, licensing, or similar agreements.

Marketplace Nexus

Certain online marketplace sales first became subject to sales tax following the passage of *Act 43 of 2017*, effective March 1, 2018. Certain marketplace facilitators, remote sellers, and referrers have the option to either collect and remit the sales tax that is due on taxable sales within the Commonwealth or elect to notify their customers that use tax may be due, and report to the Department the customers names, addresses, and aggregate dollar amounts of each customer's purchases. Effective July 1, 2019, *Act 13 of 2019* now controls, but the provisions of *ACT 43 of 2017* were suspended and not repealed. *Act 43* added the following definitions to the Tax Reform Code.

Act 43 definitions:

Remote Seller

Anyone other than a marketplace facilitator, marketplace seller, or referrer, who does not maintain a place of business in Pennsylvania, but who sells tangible personal property that would be subject to sales tax here.

Marketplace Facilitators

Persons, including vendors, who list or advertise tangible personal property for sale in any forum, directly or indirectly, collect the payment from the purchaser, and transmit the payment to the marketplace seller.

Referrer

Receives consideration to advertise a seller's products, and transfers a buyer to the seller, facilitator, or other party to complete a sale, without collecting a receipt from the purchaser.

Marketplace Seller

One who uses a marketplace facilitator to facilitate a sale.

Economic Nexus

Following the passage of *Act 13 of 2019*, taxpayers making more than \$100,000 in gross sales into the Commonwealth during the previous twelve months constitutes maintaining a place of business in Pennsylvania and establishes economic nexus.

- In determining gross sales for economic nexus purposes, a marketplace or remote seller with no physical nexus should determine their gross sales using only their direct sales and those made through a marketplace facilitator that does not collect on their behalf into the Commonwealth.
- The passage of *Act 13 of 2019* resulted in the suspension of *Act 43*. Therefore, the election to collect sales tax or comply with the use tax reporting requirement is not available for vendors with economic nexus (gross sales > \$100K).
- If the vendor's annual PA gross sales fall below the threshold in the following year, vendors are encouraged to continue charging and collecting sales tax, but they are not required.
- A marketplace facilitator that does not have physical nexus but has economic nexus must collect and remit the tax on their sales into the Commonwealth and those made on behalf of marketplace sellers, even if the marketplace seller does not individually have any nexus.

Certified Service Providers

Certified Service Providers (CSP) are third-party companies that work with the Department of Revenue to collect and remit the tax of online sellers. CSPs also provide software that can help an online seller determine what products they sell are subject to the tax. The Bureau of Audits will periodically examine these reports to ensure the tax determinations are accurate.

Marketplace and remote sellers that do not have physical nexus in the Commonwealth may outsource most of their sale tax administration responsibilities to a CSP. The CSP will facilitate the registration process, file tax returns, and collect and forward tax payments to the Department of behalf of their clients.

Tax Types

The audit of sales, use and hotel occupancy tax records is the auditor's primary area of responsibility. However, the auditor is also responsible for auditing records that deal with related taxes. A brief description of each tax is given below.

Sales, Use, and Hotel Occupancy Tax

State Sales, Use, and Hotel Occupancy Tax

Imposition and Reporting

Article II of the Tax Reform Code (TRC) of 1971 (passed as Act 2 of March 4, 1971) imposes a six percent sales tax on the sale at retail in Pennsylvania of tangible personal property and selected services (**72 P.S. §7202(a)**). This tax is normally charged, collected, reported, and remitted by the vendor.

The code also imposes a six percent use tax upon the use of tangible personal property and selected services within Pennsylvania (**72 P.S. §7202(b)**). Use tax is self-assessed, reported, and remitted to the Commonwealth by the purchaser when the vendor does not charge the sales tax.

In addition, the code imposes a six percent hotel occupancy tax on the rental charge for each occupancy of a hotel room in Pennsylvania (**72 P.S. §7210**). Article II of the Tax Reform Code of 1971 is published at Title 72 of the Pennsylvania Statutes.

Taxpayers must report the charging and self-assessment of these taxes, as well as their Pennsylvania sales activity, on a PA-3, Sales, Use, and Hotel Occupancy Tax Return, electronically either online through [myPATH](https://mypath.pa.gov/) or by calling the business TeleFile phone system at 1.800.748.8299. Any TeleFile users are required to complete the **TeleFile Request Form** and cite the reason why they cannot use the online filing options. The request form must be submitted to the Department 30 days prior to the due date of filing requirement. Taxpayers with a recurring obligation should register for an account by registering online at <https://mypath.pa.gov/>. Taxpayers that do not have a recurring obligation may self-assess use tax on a PA-1, Use Tax Return, online at <https://mypath.pa.gov/>.

Taxpayers are required to pay amounts of \$1,000 or more using an approved electronic funds transfer (EFT) method. Failure to use an approved EFT method will result in additional penalty equal to 3% of the amount of tax reported, not to exceed \$500. Taxpayers may register for electronic funds transfer online through myPATH at <https://mypath.pa.gov/>.

In addition, any taxpayer whose actual liability for the third calendar quarter of the preceding year is more than \$25,000 have a requirement to make accelerated sales tax payments (prepayments). Taxpayer's that remit more than \$25,000 but less than \$100,000 in the third quarter of the previous year must remit 50% of the actual tax liability for the current period. Taxpayers that remit over \$100,000 in tax in third quarter of the previous year **must** remit 50% of the actual tax liability for the same month of the previous year. Prepayments are due the 20th of each month. Separate payments must be remitted for the current month's prepayments and the prior month's remaining tax liability. Failure to properly calculate and pay the prepayment will result in a penalty.

Bracket schedule

The 6% Pennsylvania state sales, use, and hotel occupancy taxes are computed in accordance with a bracket schedule detailed in **72 P.S. §7203** and on the [Sales and Use Tax Rates \(REV-221\) \(pa.gov\)](#).

The tax on purchases in excess of \$1 is 6% of each dollar plus the amount from the bracket on any fraction of a dollar.

Basic Rules

Situs

Situs, for tax purposes, refers to the jurisdiction that has the legal authority to tax a transaction. The Commonwealth has jurisdiction to tax transactions reflecting sales to or use of tangible personal property within the boundaries of the Commonwealth. Use includes a right to use, possession, ownership, or custody. Goods or services that are delivered outside of the Commonwealth are not subject to tax.

Tangible Personal Property

The TRC defines tangible personal property as corporeal personal property. It includes goods, merchandise, digital products no matter how accessed or obtained, and other items. (See **72 P.S. § 7201(m)**). The sale, use, or service of cleaning, altering, or repairing of tangible personal property is also subject to tax. The tax is due upon the total purchase price.

Services

In general, services are not subject to tax; however, the law has enumerated certain services that are taxable. These include building maintenance or building cleaning services, lawn care services, disinfecting or pest control services, help supply services, employment agency services, lobbying services, credit-reporting services, secretarial and editing services, premium cable services, adjustment and collection services, self-storage services and telecommunication services.

Purchase Price

For taxable transactions, tax is applicable upon the total purchase price. The purchase price is defined as the total value of anything paid or delivered, or promised to be paid or delivered, whether it be money or otherwise, in complete performance of a sale a retail, without any deductions on account of expenses incurred such as travel time or rental or rooms, or equipment

even when those items are separately itemized in billing to customers (see **72 P.S. §7201(g)** and **61 Pa. Code §§32.1 & 33.2**).

When the purchase price of taxable and nontaxable items are not separately stated on the invoice, the entire amount billed is subject to the tax.

Statutory Exclusions

Certain items are excluded from sales and use tax by statute (see **72 P.S. §7204**). These items include such things as unprepared food, clothing for everyday wear, water, coal, medicine, Pennsylvania state flags, and US flags.

Exemptions

Pennsylvania sales and use tax law exempts certain transactions based on the type of transaction, the manner of use or the nature of the entity involved with the transaction. There are also several exemptions for sales and use tax that are found outside of the Tax Reform Code. These various exemptions are listed below. It is important to note that the specific criteria used to determine the basis for an exemption might vary among the different taxes. Therefore, the law and appropriate regulations must be consulted to determine proper application.

General Exemptions

The Tax Reform Code (TRC) includes several exemptions from the tax that are not dependent on the nature of entity involved with the transaction, but with the type of transaction or manner of use. These exemptions are listed below.

Sales For Resale

This exemption applies to property and/or services that will be resold or rented to another party in the ordinary course of business by a vendor who is in the business of selling those same goods and services (see **72 P.S. §7201(i)** and **61 Pa. Code §32.3**).

***Note:** Wholesalers prior to the implementation of prior Business Tax System (BTS) were issued a license number prefixed with a “95” to signify that they may purchase items for resale. After the implementation of BTS, the Department does not distinguish between wholesale license number and sales tax license number.*

Isolated Sales

This exemption applies to the infrequent, nonrecurring sale of tangible personal property or services acquired by a business and not sold in the regular course of business or sold by someone who is not engaged in a business. (See **72 P.S. §7204(1)** and **61 Pa. Code §32.4**). The Bureau has typically considered any sales or series of sales conducted more than three times or more than a total of seven days in any calendar year to no longer be of an infrequent or nonrecurring basis.

Multi-State Sales

This exemption applies to property delivered to a location within the Commonwealth solely for the purpose of being processed, fabricated, or manufactured into, attached to, or incorporated into personal property and thereafter transported outside of the

Commonwealth for exclusive use outside of the Commonwealth (see **72 P.S. §7201 (k)** and **61 Pa. Code §32.5**). This exemption is referred to as “special resale” as it is deemed to be a resale.

Wrapping Supplies

Returnable containers for the ultimate consumer and wrapping supplies may be purchased exempt from tax by a seller/vendor when the use is incidental to the delivery of property which the seller/vendor sells. (See **72 P.S. §7204(13)** and **61 Pa. Code §32.6**).

Nonbusiness Exemptions

There are several exemptions that are available based on who the entity is, not their business activities. Generally, there is an exemption on sales made to instrumentalities of federal and Pennsylvania state governments, municipal authorities, federal credit unions, and certain electric and agricultural cooperatives. It also extends to federal employees for Hotel Occupancy tax (**72 P.S. §7204(12)**). In addition, a limited exemption applies to institutions of purely public charity, volunteer fire departments, individuals holding diplomatic ID and tourist promotion agencies. (**72 P.S. §7204(10)**).

Business Exemptions

A limited exemption applies to purchases made by taxpayers for direct use in an exempt business activity. Examples include manufacturing, processing, mining, farming, dairying, public utilities, etc. (**72 P.S. §7201(k)**). The exemption generally applies to equipment, machinery, parts, and supplies used directly and predominantly in the exempt business activity.

Direct Pay Permits

Qualifying businesses may elect to obtain a direct pay permit. Some businesses are not able to determine the manner in which items they purchase will be used at the time of purchase. Direct pay permits allow taxpayers to purchase most goods and services exempt from tax (**72 P.S. §7237(d)**) with the exception of those items listed in **61 Pa. Code §34.45(e)**.

In order to qualify for a direct pay permit, companies must:

- Remitted at least \$10,000 in use tax to Pennsylvania during the prior year.
- Must be in compliance with all Pennsylvania state tax requirements.
- Maintain auditable records.
- Direct Pay Permits are issued at the discretion of the Department.

Geographic Exemptions

An exemption applies to purchases made by a qualifying business located within a designated geographic area. The geographic areas entitled to an exemption include Keystone Opportunity Zones (KOZs), Keystone Opportunity Expansion Zones (KOEZ's), Keystone Opportunity Improvement Zones (KOIZs), and Strategic Development Areas (SDAs).

Generally, the exemption applies to the purchase of all tangible personal property and services used exclusively within these designated areas (**73 P.S. §820.511**). It also applies to contractors

making purchases for use within the area as part of a contract with an entity located in a KOZ/KOEZ. For SDAs, the contractor may only purchase Building Machinery and Equipment (BME) tax exempt pursuant to contraction contract with an entity located in SDA.

Effective January 1, 2019, items purchased for exclusive use by an employee assigned to a SDA are exempt, even if the items may be taken out of the SDA.

Exemptions not Found in the Tax Reform Code

There are a number of exemptions from the tax that are not found within the Tax Reform Code (TRC). These entities have an exemption from sales and use tax from a different section of the law. The division maintains a list of entities at [Sales Tax Exemption Not Found in the Tax Reform Code](#).

Pennsylvania Exemption Certificate (REV-1220)

A purchase claiming an exemption on purchases of taxable goods and/or services is required to provide the vendor with a properly completed [Pennsylvania Exemption Certificate \(REV-1220\)](#) (72 P.S. §7237(c)). However, it is important to note that an exemption certificate is not required for items specifically excluded by statute, items shipped out-of-state by the vendor, or for the sale of taxable items where the sales invoice clearly shows the purchaser to be a federal or Pennsylvania state agency.

Taxpayers use this form to claim an exemption from state or local sales and use tax, hotel occupancy tax, PTA, and VRT taxes. Specific form requirements are provided in **61 Pa Code §32.23**. The auditor is required to review the taxpayer's exemption certificates to determine if each form provides a valid basis for exemption and the certificate was accepted in good faith. The form is valid only when properly completed. The auditor is encouraged to make copies of any exemption certificates disallowed in an audit and include them as exhibits in the audit report.

Completion of Form

Proper completion of the form is discussed below.

Type of Tax

The appropriate box must be checked to indicate the type of tax exemption for which the form is intended.

Unit or Blanket Exemption

The appropriate box must be checked indicating whether the certificate applies to one or several transactions.

Name of Seller or Lessor

The form must accurately provide the name and address of the seller or lessor.

Exemption Reason

The basis for exemption is indicated by marking the appropriate box.

- If box #8-Other is marked, there must be a written explanation provided in the appropriate space for the form to be valid.

Name, Address and Signature of Purchaser

This section of the form must correctly identify the purchase claiming the exemption.

Date

The date of the purchaser's signature is the date used to determine whether or not the exemption certificate was provided within 60 days of the related sale.

Exempt Organization Declaration of Sales Tax Exemption Form (REV-1715)

Exempt organizations can provide a vendor with an [Exempt Organization Declaration of Sales Tax Exemption Form \(REV-1715\)](#) in connection with the REV-1220 to claim an exemption on purchases of \$200 or more of items that may appear not to be entitled to the exemption such as for use in an unrelated trade or business or construction materials not used for routine maintenance. The certificate and the form together create a presumption of good faith acceptance on the part of the vendor and relieves the vendor from collecting sales tax. This form is only used by registered charitable organizations (exempt organizations) with a valid "75" number. The form may only be used for one invoice.

The use of the form is optional. Therefore, a vendor may elect to accept a properly completed exemption certificate from an exempt organization without this form. However, the vendor may later incur a tax liability if the Department determines that the transaction was subject to tax.

Completion of the form consist of both the vendor and the purchaser signing pre-written declaration verifying the nature of the transaction and acknowledging potential liability. The related invoice must be attached to the form.

Tax liabilities will be enforced against the purchaser if the vendor can demonstrate that the tax-exempt sale was made **"in good faith"** in the following situations:

- Sales of less than \$200 supported by a properly completed exemption certificate.
- Sales of \$200 or more supported by properly completed and retained REV-1715 and exemption certificate.

The auditor is required to document these types of transactions on a separate set of worksheets. These worksheets are then sent with a cover letter to the Sales and Use Tax Program Administrator. Complete names and addresses of the exempt organization making the purchases are mandatory for documenting these transactions.

Uniform Sales & Use Tax Exemption/Resale Certificate-Multi-Jurisdictions

The Multi-State Commission created the [Uniform Sales & Use Tax Exemption/Resale Certificate-Multijurisdictional](#) for entities operating in multiple states. Purchasers may use this form **only** when claiming the resale exemption subject to the provision of **61 Pa. Code §32.3**.

Local Sales, Use, and Hotel Occupancy Tax

Imposition and Reporting

Pennsylvania state law authorizes certain counties to impose a tax on each separate sale at retail of tangible personal property or service that originates within the county. The law also authorizes the counties to impose a tax on the use within those same counties as well as on the rental charge for a hotel room. This tax is commonly referred to as the “local” sales or use tax.

The rules for imposition, collection, reporting, and remittance are generally the same as those for state sales tax under Article II of the Tax Reform Code of 1971. However, unlike state sales tax, local tax is a point of origin tax, meaning that the local tax is only due when a sale originates from, or the items are used within the taxable county. Currently, Philadelphia and Allegheny counties are the only counties imposing the tax. Currently, the tax rate for Allegheny sales, use and hotel occupancy tax is one percent. The tax rate for Philadelphia sales and use tax is two percent and the rate for hotel occupancy is one percent. Taxpayers report these taxes under the local tax columns of the PA-3.

Bracket schedule

The 1% Allegheny County sales and use tax, and the 1% Allegheny and Philadelphia County hotel occupancy taxes are computed in accordance with **(72 P. S. §7203)** and on the [Sales and Use Tax Rates \(REV-221\) \(pa.gov\)](#).

The tax on purchases in excess of \$10.00 is 1% of each dollar plus the above bracket amounts on any fraction of a dollar.

The 2% Philadelphia County sales and use taxes are computed in accordance with **(72 P. S. §7203)** and on the [Sales and Use Tax Rates \(REV-221\) \(pa.gov\)](#).

The tax on purchases in excess of \$10.00 is 2% of each dollar plus the above bracket amounts on any fraction of a dollar.

Related Taxes

Public Transportation Assistance (PTA) Taxes and Fees

Article XXIII of the Tax Reform Code (TRC) of 1971 imposes taxes and fees on transactions involving the sale or use of new tires, motor vehicle lease tax, motor vehicle rentals, and car sharing. The provisions of Article II of the Tax Reform Code of 1971 apply to PTA taxes and fees **(72 P.S. §9301 & 61 Pa. Code § 47.19)**. This tax is also referred to as the Mass Transit Tax.

Taxpayers must report the charging and self-assessment of these taxes and fees on a PA-4, Public Transportation Assistance Fund Taxes and Fees (PTA) Return, electronically either online through at [myPATH](#) or by calling the business TeleFile phone system at 1.800.748.8299. PA-4 is filed on a quarterly basis.

Tire Fee

There is a fee of \$1.00 on each new tire sold at retail for on highway use. This would include new tires sold in conjunction with the sales of other property, such as a new car. The nonbusiness and business exemptions discussed above do not apply to the tire fee, except for sales of new tires to governmental entities.

Motor Vehicle Lease Tax

There is a 3% motor vehicle lease tax imposed on the total lease price on a contract for the use of a motor vehicle for 30 or more days (lease). If a lease is exempt from the sales and use tax, then the lease is exempt from the motor vehicle lease tax.

Motor Vehicle Rental Fee

There is a \$2.00 per day motor vehicle rental fee imposed on each day of a contract for the rental of a motor vehicle for less than 30 days. A rental that extends beyond the initial 29-day contract is still a rental and subject to the fee until the contract is terminated. If a rental is exempt from sales and use tax, then the rental is exempt from the motor vehicle rental fee.

Peer-to-Peer Car Sharing Fee

Car sharing is a membership-based service that allows a person to rent a vehicle. Members can rent a vehicle per minute, per hour, per day or on a per trip basis.

Effective October 30, 2017, an incremental car-sharing fee is computed in accordance with the following fee schedule:

Time Used	Fee
Less than 2 hours	25 cents
2 to 3 hours	50 cents
More than 3 hours but less than 6 hours	\$1.25
6 or more hours	\$2.00

Figure 1.1- Peer-To-Peer Car Sharing Fees

Effective January 1, 2023, in accordance with Act 53, peer-to-peer car-sharing programs or car sharing by a shared vehicle owner is subject to state sales tax, local sales tax and Public Transportation Assistance Fund Fees.

Vehicle Rental Tax

The Vehicle Rental Tax (VRT) is listed under Article XVI-A under the Tax Reform Code of 1971. Article II of the TRC and regulations promulgated there under apply to the VRT (**72 P.S. §8601-A ff & 61 Pa. Code §47.20**).

Rental contracts involving motor vehicles designed to transport 15 or fewer passengers, or a truck, trailer or semitrailer used in the transportation of property other than commercial freight, a tax of 2% is imposed upon the rental payments. If the vehicle rental company fails to collect the applicable tax, the purchaser shall pay the tax directly to the Department on a form prescribed by the Department. A vehicle rental company is defined as a business engaged in the business of renting five or more rental vehicles in this Commonwealth.

Taxpayers must report the charging and self-assessment of these taxes and fees on a PA-5, Vehicle Rental Tax (VRT) Return, electronically either online through [myPATH](#) or by calling the business TeleFile phone system at 1.800.748.8299. PA-5 is filed on a quarterly basis.

E911 – Pennsylvania Emergency Management Agency (PEMA)

Retailers that sell wireless telephones or pre-paid telecommunication services (i.e., pre-paid cell phone minutes or phone cards) are subject to the pre-paid wireless emergency-911 surcharge at a rate of \$1.95 per retail transaction. This surcharge is collected on each retail transaction regardless of whether the service or pre-paid wireless telephone is purchased in person, by telephone, internet or by any other method.

The pre-paid E-911 surcharge is to be charged and collected by the retailer and is excluded from the purchase price when calculating the sales tax.

The E-911 surcharge is to be reported on the sales and use tax return through [myPATH](#) with the same filing frequency and the same due dates as the seller's sales and use tax returns.

Retailers that timely report and remit the E-911 surcharge, are entitled to a 1.5 percent discount. This discount is separate from the 1 percent discount received for timely remitting sales and use tax returns and payments.

Note: The E-911 fee is \$1.65 per transaction through February 29, 2024, and \$1.95 thereafter.

Tax Collection

Amounts collected from customers from each of the taxes referenced above are considered trust fund money. Vendors are considered agents of the Commonwealth in the collection of these taxes as these taxes are paid by someone else and held in trust until they are reported and paid to the state. Consequently, vendors are required to charge, collect, report and timely remit this money to the Commonwealth (**72 P.S §7237 & 61 Pa. Code § 34.3**). Failure by the vendors to fulfill their fiduciary responsibilities in relation to these taxes successfully may result in the imposition of additional interest, penalties, fines, and/or imprisonment.

Interest and Penalty

Interest

The interest rate for any given year is established by the U.S. Treasury Secretary and is effective on January 1st of each year. The per diem rate is arrived at by dividing the announced interest rate by 365 (representing the number of days in a year) and the result becomes the per diem rate.

For taxes due after January 1, 1982, the rate of interest will vary from year to year. The date that the tax is first due and payable will determine the applicable rate of interest. This information is updated yearly on the [REV-161 1 Interest Rate and Calculation Method for Title 72 Taxes Due after Jan. 1, 1982.](#)

Interest on credits will be calculated for each reporting period based on the cumulative balance of the tax amount. Interest on periods with a net cumulative balance overpayment will be calculated at 2% less than the interest charged on underpayments.

Penalties

Understatement Penalty

A penalty is applied anytime an understatement of reported tax is determined in the amount of 5% of the amount of the understatement.

Failure to File/Major Understatement Penalty

A taxpayer failing to file any return will be charged 5% of the tax due for each month or fraction of a month that a proper return for the period remains unfiled, up to a maximum of 25% of the amount of the tax due for the period. In no case shall such charge be less than \$2.00.

If the taxpayer understates more than 50% of the true amount due, they will be charged 5% of the of the amount that was understated for each month or fraction of a month a proper return for the period remains unfiled, up to a maximum of 25% of the amount of the understatement. In no case shall such charge be less than \$2.00.

Tax Evasion (Major Penalty)

For attempt to evade or defeat a tax, there is a penalty charge of one-half of the total amount of the tax evaded. These penalties are posted under “Major Penalty”.

Multiple Additions/Penalties

A taxpayer who files a return but understates the true amount due by more than 50%, is subject to both the flat 5% understatement penalty and the 5% per month (to a maximum of 25%).

A taxpayer who fails to file a return is subject to both the flat 5% understatement penalty and the 5% per month (to a maximum of 25%), failure to file penalty for each month or fraction of a month that a proper return for the period remains unfiled.

A taxpayer who attempted to evade or defeat the tax is subject to both the charge of one-half the total amount of the tax evaded, and either one of the above referenced additions in this sub section.

Administration and Enforcement of Tax Laws

The Pennsylvania Department of Revenue is charged by the State Legislature to administer and enforce the state sales and use tax laws. Accordingly, the Department has authority to issue regulations, general rulings, and statements of policy (See **72 P.S. §6 & 61 Pa. Code §3**). The Department may also issue confidential letter rulings to individual taxpayers that

address specific questions. In addition, the Department provides general information in the form of instruction booklets, Tax Updates, tax bulletins, etc.

If there appears to be a conflict between documents within the Revenue Information System, the order of precedence shall be as follows:

- Statutes
- Regulations
- Statements of Policy
- Bulletins
- Letter Rulings
- Revenue Information

The PA Code also requires the Department of Revenue to publish a general listing of taxable and nontaxable goods and services every three years. This list is published as the "[Retailers' Information" Handbook \(REV-717\)](#) and is also posted in the Pennsylvania Bulletin.

Information Resources

A list of useful information resources and links are listed below:

Information Resource List
<u>Retailer's Information (REV-717)</u>
<u>Sales and Use Tax - Taxability of Medical & Surgical Supplies</u>
<u>Sales and Use Tax - Taxability of Dental Supplies List</u>
<u>Act-45 Contractor's Purchase for Exempt Entities</u>
<u>Pennsylvania Sales and Use Tax Mushroom Farming - Tax Exempt Items</u>
<u>Tax Information for Farmers (REV-1729)</u>
<u>Hotel Tax Matrix</u>
<u>Hotel Booking Fact Sheet</u>

Figure 1.2- Information Resource Links

Employer Withholding of Pennsylvania Personal Income Tax

The auditor is required to review a taxpayer's compliance with Pennsylvania employer withholding of Pennsylvania personal income tax concurrently with the sales tax audit.

Pennsylvania Personal Income Tax

Individuals

Each individual with gross taxable earnings over \$33 of Pennsylvania sourced income or who incurred a profit or loss from any transaction as a sole proprietor, partner in a partnership, or shareholder in a Pennsylvania “S” corporation is required to pay personal income tax at the state’s specified rate and to report their earnings to Pennsylvania (**72 P.S. §7302**). The individual’s employer normally withholds tax due on wages received. The individual should receive a [W-2 Wage and Tax Statement](#), from the employer at the beginning of the subsequent year in which the wages were earned. Individuals are required to report their earnings via a [Pennsylvania Income Tax Return \(PA-40\)](#), by April 15 of the following year. The individual must maintain the W-2 received from the individual’s employer in the event the Department requests a copy of the W-2 to verify wages. The taxpayer is also responsible for paying any additional tax due at this time. If the taxpayer is self-employed, schedules filed with the return must outline all income and expenses.

A sales and use tax audit of a sole proprietor, partnership, or an “S” corporation also involves the examination of the owner’s and partner’s PA-40s.

Partnerships

PA-20S/PA-65, Commonwealth of Pennsylvania PA S Corporation/Partnership Information Return

Partnerships and “S” corporations are required to file a [PA-20S/PA-65, Corporation/Partnership Information Return \(PA-20S/PA-65\)](#) if:

- During its taxable year, the partnership or “S” corporation earned, received, or acquired any gross taxable income allocable to Pennsylvania or,
- The partnership had at least one partner or the “S” corporation had at least one shareholder that was a Pennsylvania resident. The PA-20s/PA-65 details the partnership’s or “S” corporation’s net profit or loss allocable to Pennsylvania.

In addition, beginning in 2006, a Partner/Member/Shareholder Directory is required to be included. The form must be accompanied by [PA-41 Schedule RK-1 - Resident Schedule of Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits \(PA-41 RK-1\)](#) or [2021 PA Schedule NRK-1 - Nonresident Schedule of Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits \(PA-20S/PA-65 NRK-1\)](#) showing the apportionment of profits or losses allocable to Pennsylvania among each partner/shareholder. The individual partner/shareholder uses the appropriate schedule to help calculate their Pennsylvania personal income tax liability. The individual partner/shareholder must file a PA-40 to report the allocation and appropriate personal income tax.

Personal Income Tax Rates

Pennsylvania personal income tax is imposed at the rate of 3.07 percent against taxable income of resident and nonresident individuals, estates, trusts, partnerships, S corporations, business trusts and limited liability companies not federally taxed as corporations.

Employer Withholding Requirements

Pennsylvania law requires each Pennsylvania employer to withhold personal income tax from the taxable compensation of its employees. Employers are required to remit their withholding semi-weekly, semi-monthly, or monthly and to report these withholding quarterly via [myPATH](#) W-3, Employer Quarterly Return of Income Tax Withheld.

At the end of each year, the employer is responsible for issuing a [W-2 Wage and Tax Statement](#), to their employees reporting annual wages and the related tax withholdings. In addition, the employer must file [Annual Withholding Reconciliation Statement \(REV-1667\)](#), W-2 Transmittal, reconciling all individual withholdings to the taxpayer's annual wage and withholding totals either by mail or electronically at [myPATH](#). Records for employer withholding of Pennsylvania personal income tax are generally audited in conjunction with sales and use tax records.

CHAPTER 2- AUDIT FUNCTION

Record Keeping Requirements

The same law that imposes Pennsylvania sales, use and related taxes on certain transactions also requires vendors to maintain appropriate tax records. Specifically, a taxpayer is required to maintain records that support the information reported on all tax returns. These records must distinguish between taxable and nontaxable transactions as well as document the proper charging, collection and remitting of tax money to the Department. The taxpayer is responsible for maintaining these records for three years from the end of the calendar year to which they pertain. This requirement is determined by the time limitation on assessment and collection imposed by **72 P.S. §7258**.

Examination of Records

Title 72 P.S. §7272 states that the Department or any of its authorized agents is authorized to examine the books, papers, and records of any taxpayer in order to verify the accuracy and completeness of any return made or, if no return was made, to ascertain and assess the tax imposed by Pennsylvania state law. This also includes the right to examine taxpayer records to verify compliance with laws pertaining to employer withholding of Pennsylvania personal income tax. Taxpayers are required to provide the Department with all necessary tax records upon request. In addition, taxpayers must provide the opportunity and physical facilities to enable the Department to examine the records. The Department may use [Order to Appear](#) letters and [Secretary's Writs](#) to obtain the records necessary to conduct an audit in situations where the taxpayer fails to cooperate.

The Department is required to use audit procedures that are in conformity with the Commonwealth's statutes and the Department's regulations, rulings, and policies. These procedures involve examination of source documents, journals, ledgers, schedules, tax returns, and other records used by the taxpayer to record sales and purchase transactions as well as the withholding of Pennsylvania personal income tax. The auditor may conduct a complete review or utilize test methods that allow for the examination of a representative portion of the taxpayer's business activities. Audit findings must be documented in a report that includes a narrative, forms, schedules, and exhibits.

Confidentiality

Taxpayer records viewed by an auditor as part of an audit are confidential (see **72 P.S. §7274**). Therefore, specific discussion with those other than the taxpayer and appropriate Department personnel is forbidden. The auditor should establish that a taxpayer's representative is authorized before any information is disclosed.

In addition, auditors are responsible for maintaining strict security of written and computerized materials. Computer systems are tracked and subject to periodic monitoring and review.

The auditor must adhere to the restrictions listed below when handling private tax information.

- Confidential tax information may only be accessed and released for work related purposes in accordance with the statutes, Standards of Conduct, and Department policy.
- Confidential tax information is not to be left unattended or available for access by non-Department employees.
- The auditor must exercise care in the logging of their credentials into the Department's computer system so that no one else can access confidential tax information under the auditor's credentials.
- If an auditor is uncertain whether accessing tax information or releasing it has been authorized, the auditor must consult their supervisor.
- All legal requests, subpoenas, and court orders for tax information should be promptly sent to the Office of Chief Counsel for disposition.

Data Governance

During the course of an audit, an auditor may have access to or possession of a taxpayer's electronic financial data. It is the auditor's responsibility to ensure that this data is secure at all times.

The auditor must follow the best practices and restrictions below when handling taxpayer's data.

- All data is to be stored within the audit folder created by the Bureau's audit application software. Data should not be stored anywhere else on the auditor's hard drive. This will ensure that data is removed from the hard drive after the assignment is closed and that any data needed for the appeal process is available from the Department's secure servers.
- Data should be saved to different folders within the folder created by the Bureau's audit software that make it clear and easy to understand where the data used for different audit procedures is located. A suggested hierarchy would include sales, assets, expenses, EW, PIT, and research.
- Files transferred electronically should be done so using the Department's secure email server. If the taxpayer or their representative has requested not to use the Department's secure email server, any information containing personally identifiable information (PII) such as social security numbers (SSNs), driver license numbers, and financial account information **must** still be transferred using the Department's secure email server. At no time should PII be sent using standard email systems.
 - **Note:** FTI is further limited in how it can be exchanged. If a need to exchange this information electronically, discuss options with Computerized Audit Support (CAS).

- The Bureau's laptops are encrypted for data security. When working outside of a Regional Office, auditors must be sure to properly shutdown their laptops at the end of the day. Putting the machine into sleep mode or locking the screen is not sufficient to ensure the encryption process is completed.

All employees are reminded to read and follow policies and procedures contained in the PA Department of Revenue, Bureau of Audits, Electronic Device Acknowledgement Form.

Federal Tax Information

During the course of an audit, an auditor may need or may be provided tax information that was obtained from the Internal Revenue Service (IRS). The Bureau has created a manual [Federal Tax Information and the PA Department of Revenue, Bureau of Audits](#) that discusses in detail what constitutes federal tax information (FTI) and how to properly handle and dispose of that information. All employees are required to read and acknowledge the manual. Key highlights from this document are below.

- FTI is tax return and return information provided by the federal government to the Pennsylvania Department of Revenue.
- Calculations based on FTI, if the FTI is identifiable, become FTI.
- If information containing FTI needs to be exchanged electronically with the taxpayer, please consult with Computerized Audit Support (CAS).
- Audit reports containing FTI are to be mailed following the procedures outlined in the manual.
- Generally, FTI should not be printed. If a need to do so arises, FTI is only to be printed using the region's multifunction printer or the auditor's mobile printer if at the taxpayer's location.
- Printed FTI must be stored in a secured cabinet or desk within the regional office. If a need arises to store the FTI for a short period of time at an auditor's home, the regional manager is to be consulted. At no time should FTI be stored overnight in a vehicle.

Measuring Compliance

The measure of compliance with Pennsylvania's sales and use tax statutes and regulations as reflected in the taxpayer's records is expressed in terms of a deficiency or credit. An audit that finds a taxpayer to be in complete compliance with Pennsylvania sales and use tax laws results in no deficiency (a "none" audit). In certain circumstances, the audit may result in a credit for the taxpayer. An audit that finds the taxpayer not in compliance with the statutes and regulations results in a tax deficiency. The deficiency is expressed in monetary terms and

results in the issuance of a tax assessment against the taxpayer. The assessment will also include interest and penalty. The taxpayer may appeal the assessment to the Department's Board of Appeals and then to the Board of Finance and Revenue. The appeal process may continue through the state courts.

Taxpayer's Rights and Responsibilities

The Taxpayers' Bill of Rights requires the Department to issue a disclosure statement to all taxpayers contacted by the Department for purposes of audit (**72 P.S. §3310-202**). The disclosure statement is to include:

- The rights of a taxpayer and the obligation of the Department during an audit.
 - Prepare a written basis of assessment of any additional tax due determined from the audit.
 - Act upon requests to resolve concerns that come up during the course of an audit.
 - Allow taxpayers to make requests by going through the proper chain of command.
 - Explain the taxpayer's right to appeal the assessment of any additional tax from the audit.
- The procedures by which a taxpayer may appeal or seek review of any adverse decision by the Department, including administrative and judicial appeals.
- The procedure for filing and processing refund claims and taxpayer complaints.
- The procedures that the Department may use in enforcing taxes.

Consistent with this requirement, the Department has prepared [REV-554 \(PO\), "Your Rights as a Taxpayer"](#).

CHAPTER 3-PRE-AUDIT PROCEDURES

This chapter of the manual describes the procedures that must be followed or considered prior to examining a taxpayer's records.

Assignment Research

Audit Assignment

Every audit assignment is required to be created in the Department's PATH system. The audit will be assigned to the auditor responsible for the assignment through the PATH system in a manner determined by the regional office as required by the Bureau's policy.

Auditors should make every effort to complete audits on first in, first out basis. However, there may be instances when the audit notes indicate special instructions that an assignment is given a priority status.

Auditors will be notified of new assignments in the "My Work" Manager in the PATH system. The PATH Guidebook and the "Help" link in PATH will assist the auditor with navigation through the system. Regional offices may also notify auditors of an assignment in a different manner as they determine.

Any special instructions included in the audit notes must be addressed during the audit. Any special instructions that indicate to notify headquarters for a direct special instruction must be thoroughly explained in the audit narrative, *Conflict of Interest Statement and Auditors Comments*, or on the *Additional Headquarters Processing Request* form, whichever is appropriate given the facts. In addition, notification of action required on information forwarded to headquarters must be indicated on the Additional Headquarters Processing Request form.

Upon receiving a new audit, an auditor should create an audit folder in the Bureau's audit application software if it is not created by the regions' Clerk-Typist or Management Tech.

Taxpayer Research

The auditor is to conduct preliminary research on a taxpayer such as reviewing their reporting history, business activities, prior audits, and any interactions with the Department such as appeals or letter rulings. An [Initial Audit Research](#) checklist is available that lists all of the steps below.

Pennsylvania Tax Hub (PATH)

The Department's Pennsylvania Tax Hub (PATH) will be utilized by an auditor in conducting pre-audit research activities.

In addition to assignment tracking, PATH is used to download a taxpayer's reported information and research any notes concerning the Department's interactions with a taxpayer.

Business Trust Fund Tax Returns Download

The download files for all business trust fund taxes will be generated in PATH. The generated report for a taxpayer's reported information will be imported into the Bureau's audit application software. The following download guide are available for these taxes:

- [SUT Download](#)
- [EW Download](#)
- [Public Transportation Assistance \(PTA\) Download](#)
- [Vehicle Rental Tax \(VRT\) Download](#)

When conducting pre-audit research, the auditor should conduct a download of all the business trust fund taxes that a taxpayer is registered to report. The downloaded information is included in the audit report as "Accrual Differences" and "Filing Detail" schedules. The auditor will review these schedules to identify sales and sales tax reported, taxable to gross sales ratios, use tax reported, credits taken on the return, fluctuation of reported amounts, and returns filed late.

It may be necessary to download the reported information again if the audit period is different than the period included in the initial download.

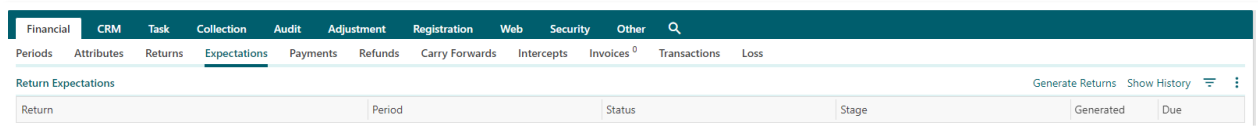
Customer and Audit Notes

The Notes tab or the Recent Notes panel in the Customer and Audit Springboards of PATH should be reviewed to see if there were any interactions between the Department and the taxpayer. This transaction is useful to see any collection efforts taken by the Department, and it may also contain information used to identify contact information.

Audit notes may contain special instructions or specific transactions that are to be reviewed as part of the audit. The treatment of the instructions during the audit must be clearly addressed in the narrative or the Conflict of Interest and Auditor's Comments, whichever is more appropriate.

Identifying Non-Filed Returns

The PATH system is used for taxpayer management, returns, processing, tax account management, revenue accounting and collections. While conducting pre-audit research, the auditor should use PATH to identify any non-filed returns. The auditor will identify any non-filed returns in the Account Springboard in the Financial tab and Expectation subtab.



Demographic information

The auditor should review the demographic information, which the taxpayer will verify during the course of the audit. The auditor will use PATH to verify mailing and physical addresses for the

taxpayer. The taxpayer will have to correct any information in this section that is incorrect by using myPATH.

Registration	CRM	Task	Collection	Audit	Financial	Adjustment	Federal	Web	Security	Other	Cnv History	Q					
Accounts	Attributes	Summary	Profiles	IDs	Names	Addresses	Contacts *	Activity Codes *	Links	Sites	Bank	Responsible Party	Power of Attorney	Out of State Licenses			
Addresses													Add	Full History	Show History		

Customer Accounts

The auditor should also be able to determine the accounts that the taxpayer is registered for through the Customer Springboard, Registration Tab, and Accounts Subtab.

Registration	CRM	Task	Collection	Audit	Financial	Adjustment	Federal	Web	Security	Other	Cnv History	Q				
Accounts	Attributes	Summary	Profiles	IDs	Names	Addresses	Contacts *	Activity Codes *	Links	Sites	Bank	Responsible Party	Power of Attorney	Out of State Licenses		
Accounts												Statement	Pay Off	Hide Ceased	⌵	⋮
Account	Parent	Account Type	Filing	Balance	Name	Address										

Prior Audits

Any prior audit for a taxpayer must be reviewed. The auditor can review any prior audits that were closed in PATH through the Customer Springboard under Audit Tab. The auditor should select “show history” hyperlink to display all prior audits closed in PATH.

Registration CRM Task Collection Audit Financial Adjustment Federal Web Security Other Cnv History 🔍												
Audits ¹		Groups ⁰										
Audits												
Show History ⌵ ⋮												
Audit	Owner	Type	Posting Prd	Program	Stage	Status	Active					

Customer Contacts

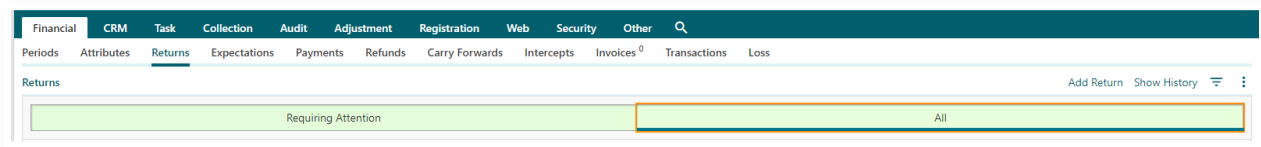
Links are also available in PATH that will allow the auditor to determine a contact person for the taxpayer. The auditor can view the Contacts subtab under Registration tab which will provide a name, phone number for the person associated with, or representative of the customer in some way.

Registration	CRM	Task	Collection	Audit	Financial	Adjustment	Federal	Web	Security	Other	Cnv History	Q				
Accounts	Attributes	Summary	Profiles	IDs	Names	Addresses	Contacts *	Activity Codes *	Links	Sites	Bank	Responsible Party	Power of Attorney	Out of State Licenses		
Contacts													Add	Show History		
Contact Type	Contact	Phone Type	Phone	Count	Profile	Account Type	Account	Valid								

Customer Returns

The Department uses the PATH system to maintain information on the filing of individual, partnership, and S Corp income tax returns. The auditor may use these documents to determine a contact person for taxpayers, affiliates, business activities, compare figures reported on the sale tax return, etc. The corporate tax returns for the audit should be saved to the audit folder, as they will be used during the audit.

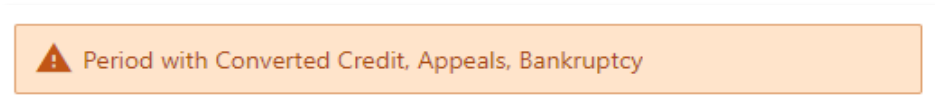
When planning the audit for these types of entities, the auditor must access the Account Springboard, Financial tab, and Returns subtab to review the taxpayer's filing history as well as the detail for the individual returns. Non-filed income tax returns must be addressed as part of the audit report.



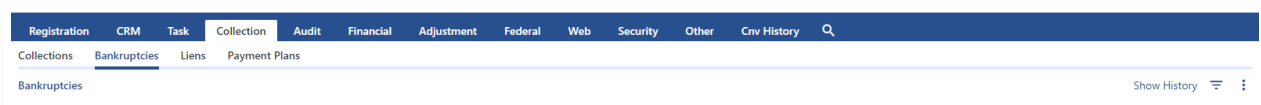
The auditor should review the returns for all principals of sole proprietorships, partnerships, LLCs, and S-Corporations to ensure these principals filed a Pennsylvania personal income tax return and to verify that the business income claimed on the return is consistent with the financial records reviewed in the conduct of a sales and use tax audit. Returns can be accessed using the taxpayer's social security number or federal employer identification number.

Bankruptcy Information

If a taxpayer has filed for bankruptcy, an "Indicator" banner will appear on the Customer Springboard and will also be displayed on the "Indicators" subtab under the "CRM" tab. The auditor can click the indicator name (*Bankruptcy*) in the "Indicator" banner to view the list and links.



The auditor can verify any information related to a bankruptcy filing for a taxpayer by reviewing the Bankruptcies subtab in the Customer Springboard Collections tab.



PA DOR Bridges

Prior to the implementation of PATH, the Department has created a website that puts information from the Department's multiple information systems on one convenient website. This website is called Bridges as it was intended to bridge the gap between all of Revenue's information systems. The website can be accessed through this link [BRIDGES](#). The entire website provides useful information; however, only information pertaining to historical data prior to November 30, 2022, will be available.

A link is available through the Bureau of Audit's main menu tab that can be used to review previous audit files and images. This page also provides a link to access previous audits closed in PATH. Audits completed prior to 2013 will have images available on the Audit Main menu. Audits completed after this date should have an image of the audit available and copy of the audit software folder that can be opened.

The “*View Imaged Returns*” link is also available in this section that will allow the auditor to review a copy of the corporate (IMG-CORP) and sales and use (IMG-S+E) tax returns filed on or before 11/30/2022. The auditor may use these documents to determine a contact person for the taxpayer, affiliates, business activities, compare figures reported on the sales tax return, etc. The corporate tax returns for the audit should be saved to the audit folder, as they will be used during the audit.

Revenue Appeals Processing System

This section provides information relating to any appeals that the taxpayer may have filed and provides a link to the Revenue Appeals Processing System (RAPS). The auditor must review RAPS for refund petitions filed for any period included in the current audit period to ensure duplicate credit is not granted within the audit and for any appeals related to prior audits. Supervisors may obtain refund decisions and file documents through email request to headquarters’ personnel. Board decisions after January 1, 2003, may be viewed together with supporting schedules via the RAPS system. The RAPS system may be accessed via this link [RAPS](#) and the Audits main menu page. After accessing the link and inputting the appropriate passwords, the auditor may select several search options from the RAPS “Main” page. If the docket number is known, the auditor may enter it into the docket number field or select the “Search” tab to query the system by taxpayer/practitioner name, business partner number, PATH account ID, account number, or employer identification number (EIN). The actual written decision will be listed under the “decision” link. Supporting documentation is listed under “Docs”.

Letter Rulings

A list of EINs of taxpayers with letter rulings is available for auditors to search. When conducting pre-audit research, the auditor must search to determine if the taxpayer is on this list. If the taxpayer is on the list, the auditor should obtain a copy of the letter ruling through an email request to headquarters’ personnel.

Internet

Taxpayer’s Website

The auditor should search the Internet for the taxpayer’s website or other links that may provide information on the taxpayer’s location, business activities, products, and annual reports. In addition, the auditor may also use the Internet to gather information about the taxpayer’s industry.

Department of State

The auditor should search the Pennsylvania Department of State (DOS) for taxpayer information. DOS can provide information relating to fictitious names, name changes, mergers, and incorporation or formation information. For taxpayers incorporated or formed in another state, that state’s Department of State website should be reviewed also.

Headquarters Information Requests

Additional information concerning the taxpayer is available from the sales tax division. This information can be requested through an email request to headquarters' personnel. The information available includes:

- Aircraft and Boat Registration
- Audit Research Questions and Account Referrals
- Bankruptcy
- Corporate Clearance
- Bulk Sale Certificate
- KOZ/KOEZ/KOIZ/SDA Exemption
- PennDOT records (vehicle registration information)

Tax Research

All pre-audit planning must include a review by the auditor of sales and use tax laws, regulations and policies pertaining to the taxpayer's business activities. The taxpayer's business activities are normally determined by the listed NAICS code, previous audit information, case notes, Department files, the Internet, invoices, advertising materials, or other information. In addition to determining the taxpayer's exposure to sales and use tax, the auditor must also determine the taxpayer's exposure to:

- Public Transportation Assistance (PTA)
- Vehicle Rental Tax (VRT)
- Employer Withholding (WTH)
- Income Tax (PIT & CNI)
- Gross Receipts (GRE & GRT)
- Malted Beverage Tax
- E911 PEMA (PEM)
- Wine Excise (WET)
- Consumer Fireworks Tax (CFT)

There are several sources of information the auditor is expected to use in determining the taxpayer's tax exposure. The sources are listed below.

Checkpoint

Thomson Reuters publishes a federal, state, and international tax reporter called Checkpoint that the Bureau uses as its main source of information on tax laws and regulations.

Checkpoint is an online resource that is accessed at <http://checkpoint.riag.com>. Thomson Reuters has a library of recorded training videos that an auditor may access via a "Product Training" link found on the right side of the Checkpoint landing page.

The majority of the information relevant to sales, use, and hotel and related taxes will be found in the Pennsylvania State Tax Reporter.

Statutes

This section contains the actual statute written by the State legislature. The sections most needed of the reporter include Articles II and XVIII of The Tax Reform Code of 1971, the Pennsylvania Intergovernmental Cooperation Authority Act for cities of the first class, the Public Transportation Assistance Act, and the Philadelphia Code - Sales and Use Tax. These sections can be found by following these links from the Pennsylvania State Tax Reporter: “Pa. Stat. Ann.”, then “Title 72 TAXATION AND FISCAL AFFAIRS”, then “Chapter 5 TAX REFORM CODE OF 1971”. Some of the most commonly cited legal cites referenced in an audit report or cited to a taxpayer in support of the audit function are:

Title	Links
<u>Act-45 Contractor's Purchase for Exempt Entities</u>	<u>72 P.S. §7201 Definitions</u>
Assessment Period for Audits	<u>72 P.S. §7258 Limitation of assessment and collection</u>
Collection of Tax & Exemption Certificates	<u>72 P.S. §7237 Collection of tax.</u>
Confidentiality	<u>72 P.S. §7274 Unauthorized disclosure</u>
Department's Right to Examine Records	<u>72 P.S. §7272 Examinations</u>
Fraudulent Returns & Other Crimes	<u>72 P.S. §7268 Crimes</u>
KOZ/KOEX Exemption	<u>73 P.S. §820.511 State Sales and Use Tax & 73 P.S. §820.705 Local Sales and Use Tax</u>
Sales Tax- A Trust Fund Tax	<u>72 P.S. §7225 Tax Held in Trust for the Commonwealth</u>
Testing Regulations	<u>61 Pa. Code Chapter 8A. Enforcement</u>

Figure 3.1 Commonly Cited Legal Cites

References to statutes in the audit report should be as specific as possible and cited using the following format:

- 72 P.S. §7201(o)(4)(B)(ii)

Regulations

The regulations represent the Department's interpretation of the law as set forth in the Tax Reform Code of 1971. They are issued by the Department of Revenue and promulgated by

the Independent Regulatory Review Commission to provide taxpayers with rules of general application so that taxpayers might clearly understand their rights and duties under the law. Sales and use tax regulations can be found in Chapters 31 through 39 by following these links: “Pa. Code”, then “Title 61 REVENUE”, then “Part 1 DEPARTMENT OF REVENUE”, then “Subpart General Fund Revenues”, then “Article II Sales and Use Tax”. ([61 Pa. Code Article II. Sales And Use Tax](#)).

References to regulations in the audit report should be as specific as possible and cited using the following format:

- 61 Pa. Code §32.21(a)(2)(ii)(B)

If the cite is used at the beginning of a sentence, the word “Title” must be inserted in front of the cite. For example:

- Title 61 Pa. Code §32.21(a)(2)(ii)(B)

Rulings

Rulings issued by the Department advise the public of the Department’s application of the tax laws to a general factual situation. A ruling is issued to ensure uniformity in the application of the law. Sales and use tax rulings can be found in Chapters 41 through 58 by following these links: “Pa. Code”, then “Title 61 REVENUE”, then “Part 1 DEPARTMENT OF REVENUE”, then “Subpart B General Fund Revenues”, then “Article II Sales and Use Tax”.

References to rulings in the audit report should be as specific as possible and cited using the same format for regulations. For example:

- 61 Pa. Code §53.1(c)(2)(xiv)

If the cite is used at the beginning of a sentence, the word “Title” must be inserted in front of the cite. For example:

- Title 61 Pa. Code §53.1(c)(2)(xiv)

Revenue Pronouncements-Statement of Policy

The pronouncements are used by the Department to interpret law or policies that the Department expects to implement in a future regulation or to follow in a future adjudication, explain an administrative procedure within the discretion of the Department, or implement an act of assembly if the Department finds it is unnecessary to use regulatory powers to perform its duties and responsibilities provided by law. The pronouncement is in effect once it is published in the Pennsylvania Bulletin. Sales and use tax pronouncements can be found in Chapter 60 by following these links: “Pa. Code”, then “Title 61 REVENUE”, then “Part 1 DEPARTMENT OF REVENUE”, then “Subpart B General Fund Revenues”, then “Article II Sales and Use Tax”. ([61 Pa. Code Chapter 60. Sales And Use Tax Pronouncements—Statements of Policy](#)).

References to pronouncements in the audit report should be as specific as possible and cited using the following format:

- 61 Pa. Code §60.6(f)(2)(iii)(A)

If the cite is used at the beginning of a sentence, the word “Title” must be inserted in front of the cite. For example:

- Title 61 Pa. Code §60.6(f)(2)(iii)(A)

Cases

This section contains opinions issued by various state courts. The opinions are organized by court and decision year.

References to court cases cited in the audit report should use the following format:

- Graham Packaging Company v. Commonwealth, 652 FR 2002 (2005)

Explanations

Thomson Reuters has prepared a number of explanations for various sales and use tax topics. These explanations can be reviewed by the auditor as they may offer additional insight, history, or plain language guidance; however, they are not authoritative and should not be cited by the auditor.

Department and Division resources

Tax Law: Policies & Bulletins

Many tax bulletins, informational notices, and select letter rulings issued by Office of Chief Counsel are available on the Department’s webpage. These may be used by the auditor in researching tax issues. Anything available on the Department’s webpage may be shared with taxpayers.

Also available on the Department’s webpage are a number of taxability lists that provide additional guidance on the taxability of medical and surgical supplies, farming items, building machinery and equipment, and hotel occupancy tax.

Division Letter Ruling Database

This topically organized database provides an index with a brief discussion of issues addressed via letter rulings that are on file at headquarters. While these letter rulings only apply to the taxpayer and the facts that they presented; they may be used as guidance in similar situations.

Appeals Decisions

Appeals decisions by the Board of Appeals (BOA) and the Board of Finance & Revenue (BFR) may be used by an auditor for guidance. Decisions of BOA and BFR for a specific taxpayer must be adhered to during an audit, unless the facts presented during the appeal differ from the facts presented during the audit. In those instances, contact the Division before proceeding.

Board of Appeals Decisions

RAPS may be searched by taxpayer or by topic to find decisions that may be helpful in researching a tax issue.

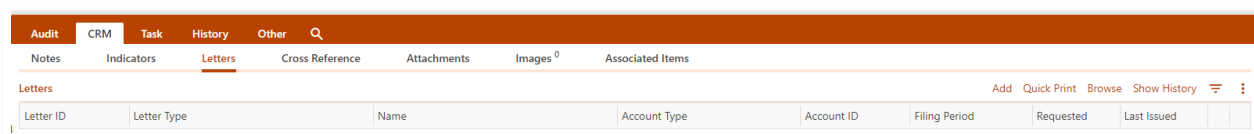
Board of Finance & Revenue Decisions

Decisions of the Board of Finance & Revenue, including dissenting opinions, are published (after deletion of certain confidential information) and available to the public for decisions issued after April 1, 2014, on the Pennsylvania Office of the State Treasurer's website. The decisions are searchable by docket number, taxpayer, or topic. These decisions are accessible through RAPS.

Contacting the Taxpayer

Audit Engagement Letter

An audit engagement letter is generated through PATH and mailed to the taxpayer (customer) in batches via overnight processing. Regional staff will add the engagement letter to the Audits Springboard under CRM tab and Letters subtab. Once the letter is created and saved, it will create a Letter ID that will be validated and added to the batch to be mailed. The letter will be printed as a PDF and saved to Bureau's audit application software. The engagement letter can be viewed in PATH by the auditor as well as the Taxpayer if they are enrolled in myPATH.



Audit CRM Task History Other							
Notes	Indicators	Letters	Cross Reference	Attachments	Images	Associated Items	
Letters							
Letter ID	Letter Type	Name	Account Type	Account ID	Filing Period	Requested	Last Issued

The letter serves as notice to the taxpayer of the Department's intent to conduct an audit. It also identifies the audit scope and records required for audit. Audit engagement letters for mandatory and out-of-state assignments must be sent within two months of headquarters creating the assignment, unless a shorter time period is required to ensure the audit is on a timeline that will protect statutory periods.

Audit Engagement Letters must be exhibited in the audit report and referenced in the audit narrative.

A template has been created in Microsoft Word and in the Bureau's audit application software for the ability to create an engagement letter manually.

In addition to the Audit Engagement Letter, the taxpayer must be sent a copy [Your Rights as a Taxpayer \(REV-554\)](#).

Telephone Contact

The auditor assigned to conduct the audit must contact the taxpayer or a duly authorized representative by telephone within 30 days of the date on the audit engagement letter to make preliminary arrangements for the pre-audit conference.

When making the call, the auditor should:

- Clearly state their name, agency, and purpose of the call.
- Obtain the name (including verification of proper spelling), title, phone and fax number, and email address of the person responsible for handling the taxpayer's audits.
- Verify the receipt of the audit engagement letter and Your Rights as a Taxpayer (REV-544).
- Verify entity name and location.
- Arrange place, date, and time for the pre-audit conference. The taxpayer should be advised at this time if additional audit staff will be attending the conference. They should also be informed of the purpose of the conference and advised that any designated representatives should be present at the conference. Directions to the location of the pre-audit conference and any other relevant information should also be discussed.
- Discuss records required to conduct the audit and obtain a brief description of the taxpayer's record keeping system.
- Discuss the taxpayer's business activities.
- Ask clarifying questions where appropriate.

A Pre-Audit Conference Questionnaire is available for the auditor to maintain record of the answers provided during the phone call and the pre-audit conference.

The auditor should keep a written record of each contact made with the taxpayer. This includes listing the name of each contact along with the date and time of the contact. The auditor must document in chronological order all attempts to contact the taxpayer and include the documentation as an exhibit in the audit report if necessary.

Confirmation Letter

The auditor is **required** to send a *Confirmation of Pre-Audit Conference* letter to the taxpayer for all out-of-state and mandatory assignments. This letter should, at a minimum, verify the date, time, and place of the pre-audit conference. The letter may be customized as required.

While not required, it is recommended that the auditor send the taxpayer a confirmation Letter for local assignments.

Templates have been created for both local and out-of-state assignments and should be used. The templates are available in Microsoft Word and in the Bureau's audit application software.

Order to Appear Letter

In situations where an auditor cannot schedule a pre-audit conference because of a lack of cooperation with the taxpayer or the taxpayer refuses to grant access to records that may be necessary to perform an audit, an Order To Appear letter should be issued.

The letter constitutes a formal legal order for the taxpayer to appear at a specified location for the purpose of producing the required documents when all other reasonable efforts to obtain the taxpayer's cooperation have been exhausted.

An "Order to Appear" letter is initiated by the supervisor and issued by the regional manager. The letter should be addressed to each owner, partner, officer, or other responsible individual. The information to be included in the order consists of the individuals name, title, and address; the specific records requested; and the exact time, date, and location where such records are to be presented. The order must be sent at least 21 days prior to the appearance date set forth in the letter via certified return receipt mail.

The [Order To Appear](#) template should be used and must be included as an exhibit in the audit report and referenced in the audit narrative.

Secretary's Writ

A [Secretary's Writ](#) may be used when the Department determines that it is necessary to issue a formal demand for access to the financial records or information pertaining to the tax matters of a particular individual or business. The Writ is prepared by the regional office and forward to headquarters for the signature of the Secretary of Revenue. The Department seal is affixed to all writs. Legal citations pertaining to the Writ are listed on the front page.

Before Requesting a Secretary's Writ

Before requesting the Executive Office to sign-off on a writ, the auditor will first send to taxpayer a letter notifying them of their legal obligation to provide records necessary to conduct an audit and the department's legal obligation to keep those records confidential.

If the taxpayer is cooperating with the audit process but feel they need the writ to overcome confidentiality issues, the auditor will send the *Prewrit Cooperative Letter* along with a *Request for Financial Records* form detailing the records that the taxpayer is to provide. The templates for these documents are available in the Bureau's audit application software.

If the taxpayer is **not** cooperating with the audit process by not providing the records necessary to conduct the audit, the auditor may send *Prewrit Nonresponsive Letter* along with a *Request for Financial Records* detailing the records that the taxpayer is to provide. The templates for these documents are available in the Bureau's audit application software.

Requesting a Secretary's Writ

Once the time has expired to provide the records, the regional office should prepare the [Secretary's Writ](#). The writ must contain the following information:

- Name and title of the representative being served the writ.
- Address where the writ is to be served.
- Legal name of the taxpayer.
- Audit period.
- Auditor's name and title who is to receive the requested records.
- Office address where the records are to be provided.
- Date and time that the records are to be provided.

- In all cases, the date that records are to be provided should allow for 45 days from the date it is submitted to headquarters to allow for processing.
- A detailed list of all records that are to be provided.
- If multiple Writs are needed for the same audit, all writs should be completed at the same time. This usually only occurs when Writs are requested for owners, officers, or partners and financial institutions.

The completed writ(s) should be submitted to the Program Administrator along with the following information:

- Assignment number, audit period, EIN, and tax account number.
- A report outlining the facts in the case, such as attempts to contact the taxpayer and the taxpayer's failure to provide requested information.
- Copies of correspondence, log of phone call, visits, Order to Appear Letter, and certified mail receipt, or statement from the auditor attesting to receipt of the Order to Appear Letter by the taxpayer.

Headquarters' personnel will obtain the signature of the Secretary's designee on the writ.

Taxpayer Delay

The taxpayer may find it necessary to delay the audit for various reasons. Where it is apparent that the reasons stated by the taxpayer are authentic and not intended to interfere with the orderly conduct of an audit, the auditor may arrange for a date sometime in the future for a pre-audit conference. In the event of repeated postponements, or a postponement of over 60 days, the taxpayer must request a postponement in writing on company letterhead or email. The request must include the reason for the delay and the date when the pre-audit conference can be held. The taxpayer should be asked to provide the letter within two weeks. The proprietor, a partner, or a corporate officer must sign the letter or send the email.

This letter must be included as an exhibit in the audit report and referenced in the audit narrative.

When scheduling is delayed at the taxpayer's request or the taxpayer is not providing records that allow for the timely completion of the audit before statutory periods expire, a waiver is to be obtained.

Pre-Audit Conference

During the pre-audit conference, the auditor should exercise every reasonable effort to secure the goodwill and cooperation of the taxpayer. Since the conference is only the preliminary or introductory phase of the audit, the discussion with the taxpayer of business activities, maintenance and retention of records, and various methods of audit procedures should be general in nature.

The audit period is normally established during the pre-audit conference. The taxpayer should be informed that if circumstances prevent the audit fieldwork from concluding within a reasonable time from the pre-audit conference, the audit period will be extended. If delays prevent the fieldwork from being completed within twelve months and the originally determined audit period

end date does not bring the audit period through the end of the calendar year, the auditor is required, at a minimum, to extend the audit period to include the entire calendar year.

The Department is required, upon advance written request of the taxpayer, to make an audio recording of the pre-audit conference at the taxpayer's own expense and with the Department's equipment. The taxpayer may also make an audio recording of the interview with the taxpayer's own equipment if, prior to commencement of the interview, the taxpayer notifies all parties present that the interview will be recorded (**72 P.S. §3310-203**).

A [Pre-Audit Conference Questionnaire](#) is available for the auditor to record the information listed below.

Preliminary Information

The auditor, after presenting their credentials to the taxpayer, secures and records the names, official titles, or in the case of outside representatives, the professional status and authorization of all persons attending the conference on behalf of the taxpayer. This information should be recorded for inclusion in the audit narrative.

The auditor should again verify receipt by the taxpayer of the Audit Engagement Letter and [Your Rights as a Taxpayer \(REV-554\)](#). If the taxpayer or their authorized representative indicates that these items have not been received, the auditor must provide copies.

Statement of Purpose and Request for Cooperation

The auditor should inform the taxpayer of the Bureau's intent to perform a routine sales and use tax audit. Also, assure the taxpayer that the orderly procedures of the business operations will not be disrupted or interfered with to an extent greater than is absolutely necessary to conduct the examination.

The auditor should state the audit period subject to audit. Normally an audit period consists of all reporting periods within the last three complete calendar years and the reporting periods required to have been reported in the current year as of the date of the pre-audit conference.

The auditor should state that a limited examination of employer withholding will also be conducted. The auditor should state that if the taxpayer is found to have exposure to other taxes and fees administered by the Department, a limited examination will be conducted in these areas as well. If a deficiency results from the examination, a separate audit assignment will be issued on the specific tax.

Business Activities

Through discussion with the taxpayer, the auditor should determine the overall nature of the business activities, operations, nexus with Pennsylvania, number of business locations, type of entity, changes in entity, changes in divisions, affiliates, and other related parties. The auditor must then determine the taxpayer's business entity, affiliates, and business activities in Pennsylvania. The auditor must identify sales locations, including out-of-state locations making sales into Pennsylvania, as well as locations in counties that impose a local sales tax. The auditor must record information regarding the type of business activity and the taxable and

nontaxable sales and purchases made by the taxpayer. Business activities between affiliates must also be recorded so that they may be later described in the audit report.

A list of business locations must be included in the audit report when the taxpayer has more than one Pennsylvania business location. This list must provide a brief description of each location (e.g., manufacturing facility, warehouse, admin office, etc.) and clearly indicate those locations in counties that impose a local sales tax. In addition, locations operating with a KOZ/KOEZ/SDA must be identified. The list must also include the beginning and ending dates of those locations that did not operate for the entire audit period. This list should be included as an exhibit in the audit report. A copy of the taxpayer's current annual report may provide most of this information. The auditor should request a tour of the taxpayer's business operations. These arrangements should be made definite as to time, place, and persons involved. Inform the taxpayer that it is a necessary prerequisite to the conduct of an audit to become thoroughly familiar with the nature of the taxpayer's business activities and operations prior to the design of any audit procedure. The auditor should document these items in the audit narrative.

System Survey

The auditor must obtain a description of the taxpayer's record keeping system throughout the audit period including:

- Accounting year (fiscal or calendar),
- Changes in record keeping or accounting systems,
- Accounting basis (accrual, cash, etc.) for sales and use and federal and state income tax returns, and
- Type of accounting system (computerized, manual, combination, etc.)

The auditor should determine what changes, if any, the taxpayer has made to its accounting and reporting methods. A description of the changes and the reporting periods in which the changes took place must be explained in the audit narrative.

The description obtained from the taxpayer should be sufficient for the auditor to understand the audit trail for sales, use and hotel occupancy purposes, as well as EW, PTA, and VRT taxes, when applicable.

The auditor must identify and discuss with the taxpayer non-filed returns, late filed returns, filing without remittance, and the taxpayer's reporting cycle.

A written description of the audit trail and items discussed with the taxpayer are required to be included in the audit report. All records referred to in the audit procedures section of the narrative must be explained as part of the audit trail in the system survey section of the audit narrative. Understanding the record keeping system from the initial transaction through to the preparation of summary financial records and tax returns is critical for determining the most efficient and effective audit procedures. Identifying how source records are stored including sales invoices, exemption certificates, and purchase invoices is key for evaluating how fieldwork could contribute to the timely completion of an audit.

Registration

Bureau of Audits-Registration Verification

If the taxpayer under audit is registered with the Department, the auditor is required to present the taxpayer with the [Bureau of Audits-Registration Verification](#) form. The taxpayer or their authorized representative should be informed that the completed form will be used to verify that all information on file with the Commonwealth for the subject taxes is current. This form should be completed by the taxpayer or their authorized representative at the pre-audit conference or as soon as possible after and returned to the auditor.

The auditor is required to review the form to make sure it is complete and then compare the information on the form to PATH. In addition, the auditor should take special note of changes in ownership (entity changes), bulk sale or merger information indicated on the form. These actions may require the creation of additional audit assignments.

The taxpayer, or their authorized representative, must be notified of any changes or corrections needed to their account. The taxpayer, or their authorized representative, is required to update the account information through [myPATH](#).

If the taxpayer refuses to complete the registration update form, the auditor is required to complete the form using information found in researching the taxpayer.

Non-registered Taxpayers

PATH requires every taxpayer to have an account to create an audit. Audits issued on a non-registered taxpayer will be issued on account request by division staff. The Bureau of Registration and Taxpayer Management (BRTM) will create the sales and use tax account and put it in a "Pending Registration" status until the taxpayer registers online through the "*Pennsylvania Online Business Tax Registration*" via [myPATH](#).

Upon completion of the audit, it is the auditor's responsibility to determine if the taxpayer will have an ongoing obligation to file sales and use tax returns. Work items in PATH will be used to instruct the Department how to address the account. Additional instructions can be found at Non-registered Taxpayers.

Pennsylvania Online Business Tax Registration

If the taxpayer will have a recurring sales and use tax obligation in the future or the current audit assessment includes trust funds of over \$500, the taxpayer, or their authorized representative, must register for a sales and use tax license by completing the Pennsylvania Online Business Tax Registration through [myPATH](#).

In these cases, the auditor must complete a Registration Change work item in PATH and indicate that the taxpayer needs to complete registration for their sales and use tax license. If the effective date is different than the beginning of the audit period, the actual effective date of the license should be included.

BRTM will issue a letter to the taxpayer that will contain a Letter ID that the taxpayer will use to complete their registration online. Failure by the taxpayer to complete the registration process can result in additional actions by the Department.

Temporary Account

In situations where:

- the resulting liability is all use tax, and the taxpayer will not have an obvious use tax liability in the future, or
- sales tax liabilities were established on additional taxable sales and the taxpayer will not have a sales tax liability in the future because the taxpayer under audit is no longer in business or the entity is no longer making taxable sales.

Any liabilities will be assessed using the account created to issue the audit. The auditor must complete a Registration Change work item *form* and indicate that the account should be cancelled effective the last day of the audit period.

Requirement for the Audit Review of Third-Party Credits

The auditor is required to present this form to the taxpayer at the pre-audit conference. The auditor must include a date on the form by which the taxpayer must present documentation to support third party credits requested by the taxpayer for inclusion in the audit report. The auditor should review the contents of the Requirements for the Audit Review of Third-Party Credits with the taxpayer or their representative, answer any of the taxpayer's questions regarding the form, and obtain a signature of the taxpayer's representative acknowledging that they received a copy of the form. Should the taxpayer's representative decline to sign the form the auditor should indicate on the form, the date the form was presented, who it was presented to, and that the "*Taxpayer declined to sign the form.*"

Discussion and Preliminary Conclusion

Discuss with the taxpayer the techniques or procedures usually followed by the Bureau in conducting an audit based on the current available information. However, the taxpayer must be informed that the auditor may be compelled to change the discussed procedure once the records are examined.

Arrangements

The auditor should request that necessary records and adequate physical facilities be made available to conduct the audit. The auditor should also determine office hours and the taxpayer's contact person(s) that will be assisting in the conduct of the audit.

Direct Payment Permit Holders

The auditor is required to verify that all information on the most recent application for direct payment permit on file with the Bureau is complete and accurate. The auditor must obtain an updated Application for Direct Payment Permit when any of the following have occurred since the most recent application was filed:

- Name Change.
- Business locations added or discontinued.
- Sales and tax license number change.
- Business activities change.
- Business activities qualifying for the business exemption have been discontinued.
- Mergers

At the conclusion of the audit, the auditor must make a recommendation regarding the taxpayer's continued use of the direct payment permit. A memo must be attached to the Additional Headquarters Processing Request advising headquarters of the auditor's recommendation.

The auditor's recommendations should be based on the following:

- Has the taxpayer remitted at least \$10,000 in use tax to Pennsylvania during the prior year?
- Is the taxpayer in compliance with all Pennsylvania state tax requirements?
- Does the taxpayer qualify for a business exemption?
- Has the taxpayer maintained auditable records?

When the auditor recommends revocation of the taxpayer's direct payment permit, the memo must clearly state the reason for revocation (e.g., lack of records, no longer qualify for a business exemption).

A copy of the taxpayer's most recent application may be requested from a sales and use tax audit program specialist.

KOZ/KOEZ

The Department defers to the Department of Community and Economic Development (DCED) on the issue of qualification for benefits related to a Keystone Opportunity Zone/Keystone Opportunity Expansion Zone. If DCED determines that an entity is a "qualified business", DOR accepts the determination and grants benefits accordingly.

During an audit, the auditor is required to verify that the KOZ/KOEZ account number currently being utilized by the taxpayer is current and valid by requesting verification from the appropriate headquarters personnel.

Note: All KOZ/KOEZ exemption numbers will start with the prefix "72".

The auditor must further verify that all purchases for which the taxpayer is claiming the exemption are used or consumed exclusively within the KOZ/KOEZ (see **73 P.S. §820.511**).

Plant Tour

When auditing an entity claiming a business exemption, the auditor should make arrangements for a plant tour at this time. Failure of the taxpayer to comply with this request constitutes a scope limitation since the auditor cannot visually determine if the taxpayer qualifies for the business exemption and/or identify the property directly used in the operation. Refer to [Conducting Plant Tours](#) in Chapter 4 for further procedures.

CHAPTER 4- AUDIT PROCEDURES

This chapter of the manual describes the procedures that must be followed or considered while examining a taxpayer's records.

The taxes covered include:

- Sales Tax
- Use Tax
- Hotel Occupancy Tax
- Public Transportation Assistance Fund Taxes and Fees (PTA)
- Vehicle Rental Tax
- E-911 PEMA

In addition, the minimum requirements to be conducted for Employer Withholding of Pennsylvania Personal Income Tax (EW) and Pennsylvania Personal Income Tax (PIT) are explained within.

Auditors must prepare schedules or workpapers showing all audit procedures discussed in the audit narrative, unless the records provided and exhibited clearly show that the records referenced in the procedures reconcile. At a minimum, these schedules or workpapers are to be included in the audit folder of the Bureau's audit application software. Any schedules or work papers supporting any audit adjustment must also be included in the audit report. Any original transactional data files received for the audit must also be saved in the audit folder of the Bureau's audit application software. This information is useful upon appeal of the audit and in order to verify that the audit was completed in accordance with the procedures discussed within this manual.

Sales Tax

Gross Sales

The objective of the gross sales examination is to determine that all categories and sources of sales are properly included on the Sales and Use Tax return and are made available to the auditor for examination. The examination of gross sales is conducted to:

- Become familiar with the business activities and locations (determine exposure to local sales tax),
- Substantiate that all business activities are made available for audit,
- Verify completeness of sales records provided for examination,
- Determine all sources of taxable sales and sales tax charged,
- Establish the credibility of records,
- Identify affiliates and intercompany transactions,
- Ensure accurate basis for the selection of test periods, and

- Determine the areas of potential other tax exposure.

The auditor will use the information gathered regarding the completeness, availability, and credibility of records during the examination of gross sales to determine the type of audit that will be performed on sales.

Prior to the examination of gross sales, the auditor should review the chart of accounts to become familiar with the sales accounts that would be expected to be included in the gross sales reported on the Sales and Use Tax Return.

Comparison with Income Tax Returns

Reported gross sales from the Sales and Use Tax Return (Accrual Differences schedule) must be compared to the sales on a federal income tax return for a minimum of at least one year during the audit period. Corporations that are subject to tax in multiple states include a RCT-106, Determination of Apportionment Percentage, with their RCT-101, PA Corporate Tax Report, that identifies sales made within Pennsylvania. Similarly, S-corporations and partnerships include a PA Schedule H, Apportioned Business Income (Loss)/Calculation of PA Net Business Income (Loss) with their PA-20S/PA-65, PA S Corporation/Partnership Information Return, that identifies sales made within Pennsylvania. The RCT-106 or PA Schedule H may be used to compare the sales and use tax return to adjust the sales made inside Pennsylvania. Differences must be reconciled.

If the sales of the income tax return are higher than the sales and use tax return, the auditor should determine the general ledger accounts to which the differences relate and determine if the sales of the income tax return should be included in the audited gross sales on the “Accrual Differences” schedule. If the difference cannot be reconciled and the taxpayer cannot provide a satisfactory explanation of the difference, the auditor should compare the income tax returns to the reported amounts for the remainder of the audit period. The taxpayer should be given a schedule documenting the differences and a *Request for Financial Records* requesting that the taxpayer provide an explanation and documentation to explain and support the differences.

If the examination reveals or documentation is provided to determine that the differences are related to obviously nontaxable categories of sales, such as real estate rents or royalties, no adjustments should be made to the audited gross sales on the “Accrual Differences” schedule.

If the examination reveals or documentation is provided to determine that the differences are related to sales with possible sales tax exposure that have not been reported or no documentation is provided to substantiate the difference, the audited gross sales on the “Accrual Differences” schedule should be adjusted to agree with the income tax return. Documentation provided to substantiate the differences that have possible sales tax exposure should be examined as part of the taxable and nontaxable sales examination. A Gross Sales Assessment should be made on any unsubstantiated differences in sales.

If the income tax return sales are lower, the taxpayer should be given a schedule documenting the difference and a Request for Financial Records requesting that the taxpayer provide an explanation and documentation to explain and support the differences. Any material, unexplained differences should be considered for their effect on income tax and either referred to headquarters for a collateral audit assignment or referral to the Bureau of Desk Review and Analysis (BDRA).

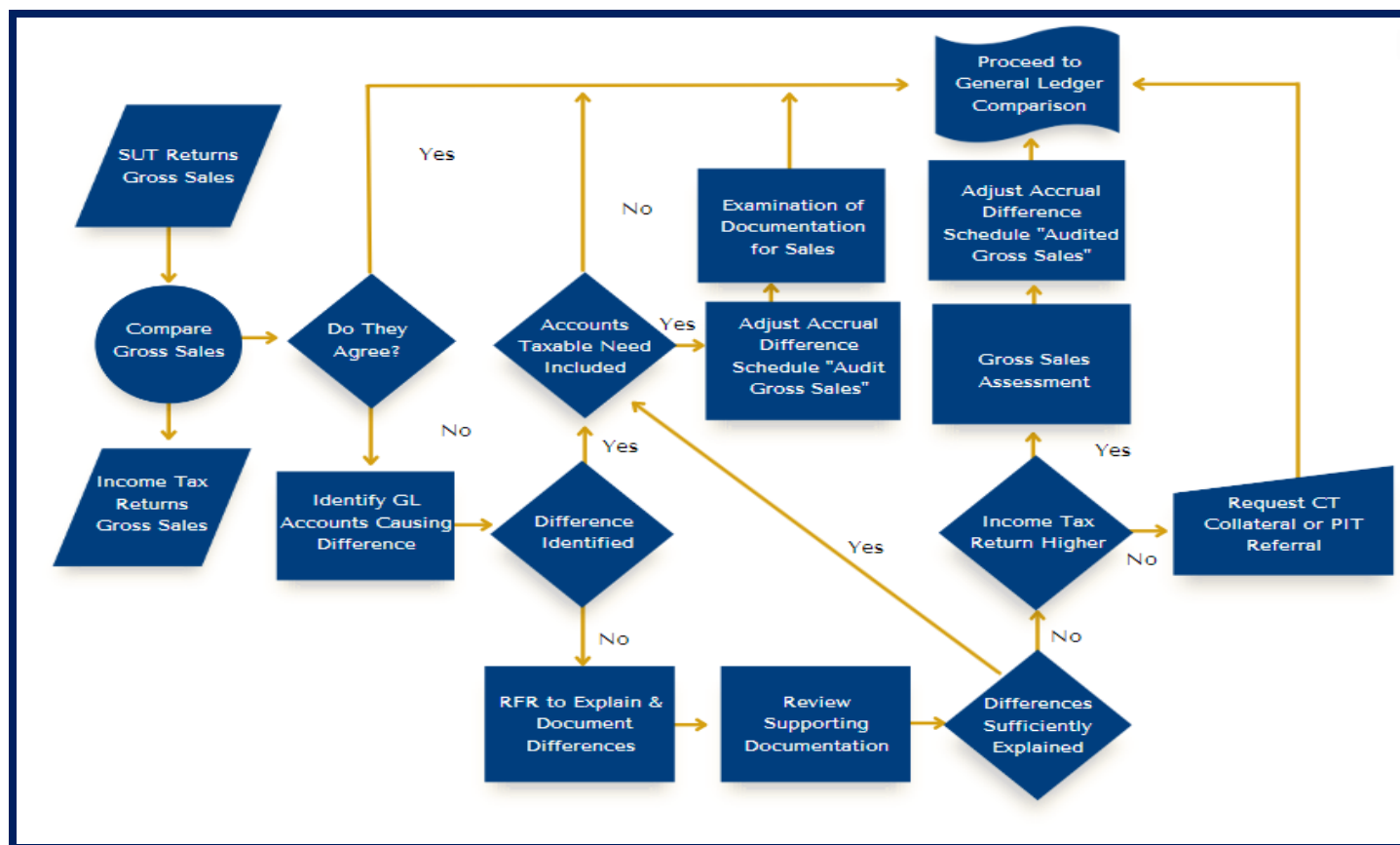


Figure 4.1: Gross Sales to Income Tax Return Flowchart

Sales of Business Property

Generally, the sale of a business's assets would qualify as an exempt isolated sale. However, if the business should sell their assets frequently enough to no longer qualify as an isolated sale or they sell assets that are used in the ordinary course of their business, such as rental equipment, there may be exposure to sales tax. Companies are required to report their gain or loss on the sale of business property on their income tax return. If a gain or loss is identified on the income tax return, the auditor should examine the Federal Form (FF) 4797, Sales of Business Property. The gross sales price, or proceeds, from the sales of business property used in ordinary course of business or that no longer qualify as an isolated sale should be examined as part of the taxable and nontaxable sales examination. Additional information, such as an asset disposal listing or journal, may need to be requested to identify the assets, proceeds, and frequency involved.

Other Income

In addition to the sales reported on the income tax return, an examination should be conducted of the other income section of the income tax return. Many times, companies will report income that is not related to their primary trade or business as other income. Taxpayers are required

to include a statement describing the type of income with their tax return. The taxpayer should be asked to provide documentation for any types of other income from sources other than obviously nontaxable categories of sales.

Documentation provided for income types that have possible sales tax exposure should be examined as part of the taxable and nontaxable sales examination. A Gross Sales Assessment should be made on any potentially taxable types when no documentation is provided.

Deductions

Occasionally there are deductions on the income tax return that need to be considered as part of the sales tax examination. These deductions relate to contra expense accounts (expense accounts that have a normal credit balance instead of a normal debit balance) or other expense accounts with a credit balance and are typically shown as a negative (-) deduction on the income tax return. These accounts are typically shown either as an offset to another deduction on the taxpayer's own return or as an offset to an affiliate's expense in a consolidated group.

The taxpayer should be asked to provide documentation for any negative deductions that have potential for sales tax exposure. Documentation provided for income types that have possible sales tax exposure should be examined as part of the taxable and nontaxable sales examination. A Gross Sales Assessment should be made on any potentially taxable types when no documentation is provided.

Comparison With General Ledger

Reported gross sales should be traced to the general ledger accounts for the audit period. This comparison may be done on a reporting period or annual basis. The auditor should prepare a reconciliation schedule to verify that all locations and applicable general ledger accounts are included in the total book gross sales. Audited gross sales should be adjusted on the "Accrual Differences" schedule to reflect differences found by the auditor.

During the verification that sales from all locations are included in the gross sales amounts reported, the auditor must identify locations that are physically located in a county that imposes a local sales and use tax. The gross sales from these locations should be compared to the gross sales reported for each taxing jurisdiction. The results should be recorded on the "Accrual Differences" schedule.

Comparison with Original Books of Entry

The auditor should verify the completeness of the records made available for audit. The original books of entry (e.g., accounts receivable journal, cash receipts journal, sales journal) should be traced to the general ledger sales accounts to ensure that all sources of sales were properly recorded for a minimum of one year within the audit period.

When discrepancies are found, the auditor should examine additional periods to determine if the unrecorded or erroneously recorded transactions were isolated or recurring. If the discrepancies are found to be recurring, the auditor should prepare a reconciliation schedule for the audit period. Audited gross sales on the "Accrual Differences" schedule should be adjusted to reflect the unrecorded or erroneously recorded sales.

The auditor must approximate the number of sales transactions per month and identify how the approximation was determined. A sample of entries should be traced from the books of original entry to the source document to verify proper recording and existence of source documents. Source documents include items such as sales invoices, cash register tapes, hotel guest folios, and general journal posting vouchers. A sample of source documents should be traced to books of original entry to verify completeness of recorded sales. Exceptions should be noted in the audit report.

The auditor should vouch a sample of entries in the general ledger to the original books of entry to assure that all are made available for examination. Unusual entries or adjustments to the general ledger accounts should be investigated and clearly explained in the audit report when they affect the audit findings.

General journal entries posted to general ledger sales or income accounts should be investigated to determine if the entry represents sales to affiliated interests or intercompany transactions. These entries should be documented in the audit report when the intercompany transactions are determined to include taxable transactions. These transactions should be assessed as additional taxable sales if the taxpayer did not properly tax them. Intercompany transactions including taxable transactions commonly identified during an audit include canned computer software, equipment rental, and help-supply, secretarial and editing, and employment agency services. Intercompany transactions may also be identified by examining eliminations made on the consolidated federal income tax return. Additional information, such as a transfer pricing study or management or rental agreement, may be required to determine the items or services transferred and that the transaction occurred at arms-length terms and prices.

The information obtained regarding the availability, credibility, and completeness of the records presented during the gross sales verification should be used by the auditor to determine the type of audit that should be conducted on the taxed and nontaxed sales portion of the audit.

If the taxpayer has exposure to hotel occupancy tax, the auditor should identify the records necessary to separate sales subject to sales tax from those subject to hotel occupancy tax. The auditor should also determine exposure to public transportation assistance taxes and fees (PTA) and vehicle rental tax (VRT) and determine if a collateral audit should be requested. Minimum requirements regarding taxpayers with exposure to PTA or VRT are separately outlined in respective sections of this chapter.

Sales Tax Accrual

General

A complete reconciliation of accrued state and local sales tax per books to the reported state and local sales tax is required for every reporting period in the audit period. The procedures in this section are required for both state and local sales tax. The auditor must be completely familiar with the taxpayer's procedures for the reporting of sales tax charged & collected in order to ensure the proper reporting. For audit purposes, the accrued sales tax per books can be the general ledger sales tax account, a sales journal or any other type of sales listing that includes a sales tax entry listed from the source documents that can be totaled to arrive at the total sales tax charged & collected for the reporting period. The auditor should verify that all sources of both state and local sales tax were included in the total sales tax accrual amounts reported.

When the taxpayer has multiple locations and/or multiple sales journals, the auditor should verify that all sources of sales tax were posted to the sales tax accrual account for each reporting period. The auditor should verify that local sales tax from all locations identified in counties that impose a local sales tax are included in the sales tax reported for each applicable jurisdiction.

The taxpayer is required to report the greater of the sales tax actually charged and collected or sales tax as computed by the applicable sales tax rate multiplied by the taxable sales. In situations where actual taxable sales are identifiable, the auditor should verify that the larger of the two amounts were used for reporting purposes.

The auditor should trace sales tax listed on the sampling of source documents to the sales tax accrual account in order to verify the proper recording and posting of state and local sales tax. The audit trail should be explained in the audit narrative.

Reported and audited state and local sales tax is included on the “Accrual Differences” schedule created by the import process in the Bureau’s audit application software. This schedule is included in every sales and use tax audit report and referenced in the audit narrative. All unreported trust funds must be recorded in the audit report on this schedule.

If discrepancies are found, the auditor should prepare a schedule and include it in the audit report to document accrued amounts not included in the reported tax amounts. The “Audited Tax Accrual” amounts on the “Accrual Differences” schedule should be adjusted to reflect the auditor’s findings. Additionally, the source of the adjustment should be included as an exhibit in the audit report.

If the auditor is unable to perform a reconciliation of accrual amounts, a statement should be included in the narrative indicating as such.

Reporting Basis

A taxpayer must report all sales tax on sales made during the reporting period (**61 Pa. Code § 34.3(b)(2)**), whether payment was received or not, i.e., the accrual basis.

When a sale is wholly or partially on credit, the buyer must pay the full amount of sales tax due on the entire purchase price within 30 days after the purchase, (**61 Pa. Code § 33.4(a)**). The tax on credit sales must be reported by the taxpayer either on the return covering the period the sale was made or when the tax was due to be collected from the customer.

When sales are made by layaway, the taxpayer is required to collect and report the tax on the full purchase price at the time of the first payment after the goods are reserved, or within 30 days after the goods are reserved, whichever occurs first.

Sales Tax Reported on Other Basis

In situations where sales tax is being reported on a basis other than described above (i.e., cash basis), the auditor is required to perform procedures to identify the tax that has not been reported but was due.

The auditor should first verify the reported tax amounts agree with the basis the taxpayer used for filing and all other requirements detailed in this section. The auditor should then prepare a

schedule that identifies all sales tax that was due to be reported during the audit period that have not been included on any return, even if that return is outside of the audit period.

First Time Audit

When the sales tax accrual account must be converted to the correct basis, any deficiency will be assessed in the last period of the audit via the **Accrual Differences** schedule. The auditor must request via the *Additional Headquarters Processing Request* form, a letter to be sent to the taxpayer from Headquarters. The letter will advise the taxpayer that the sales tax must be reported on an accrual basis and that similar deficiencies in subsequent audits will be assessed on a period-by-period basis.

Subsequent Audits

If the sales tax accrual account must be converted to the accrual basis in subsequent audits, any deficiency will be assessed on a period-by-period basis.

Debits to the Accrual Account

The auditor should review the sales tax accrual account(s) and determine the source of all material debits (adjustments) that are unrelated to the payment or pre-payment of sales tax on a corresponding return. The auditor should review the sales tax account(s) to verify that the taxpayer did not make unallowable deductions for bad debts. Material, invalid, or unsubstantiated reductions to the sales tax accrual account should be listed. The listing along with a *Request for Financial Records* form requesting that the taxpayer provide documentation supporting the reduction to the accrual account should be given to the taxpayer. If the taxpayer does not adequately explain or cannot substantiate the reduction, the auditor should include the amounts in the audited sales tax on the Accrual Differences schedule and assess the difference. The source of any unsubstantiated reduction should be included as an exhibit in the audit report.

Accelerated Sales Tax Payments

Accelerated sales tax payments should be included in the sales tax accrual like any other payment. Taxpayers should not reduce their total sales tax reported on the sales and use tax return for any accelerated payments that were made. They must report the total tax collected or due for the reporting period. Accelerated sales tax payments made through myPATH, will automatically populate in the “Previous Payments” box. This box will only display payments that have been processed.

Credits Taken on The Return

The sales and use tax return (PA-3) provides for a credit to be taken against the overall remittance on TPPR Credit box of the PA-3 Sales and Use Tax Return via myPATH. Credits taken on the return will be included on the download from PATH and will appear on the Filing Detail in the Bureau’s audit application software. The auditor should reference credits taken in the audit report and verify the source and validity of the credits. Credits for other than Department approved credit memos or verifiable Taxes Paid on Purchases Resold (TPPR) should be listed on a separate schedule. If the taxpayer erroneously took a credit on their return

for taxes that they would otherwise have been entitled to take against their sales or use tax account (i.e., a credit for sales tax erroneously accrued and remitted in a previous reporting period), the taxpayer should be notified of the proper method for taking such a credit. The fact that the taxpayer was notified of the proper method should be included in the audit narrative.

One Percent Discount

The taxpayer may take a one percent discount (*up to a maximum of \$25.00 for monthly filers, \$75.00 for quarterly filers, and \$150.00 for semi-annual filers*) of the total sales tax reported on the tax return for sales tax timely reported and remitted. The one percent discount is not applicable to use tax. When a taxpayer has reported use tax as sales tax and has taken the one percent discount, the auditor must assess the taxpayer for the amount of the unallowable one percent discount taken.

Taxes Collected not Reported

When trust fund deficiencies of \$1,000 or more are established, a list of responsible parties must be attached to the *Additional Headquarters Processing Request* form and forwarded to headquarters. The list should include the name, title, social security number, and home address of the owners, partners, or corporate officers. The list of responsible parties may not be included in the audit report of the entity due to the nature of the confidential information.

Also, in a situation where the taxpayer is found to have charged or collected sales tax and did not report such tax, the auditor is required to determine if major penalties are appropriate. For an attempt to evade or defeat the tax, there is a penalty of one half of the total amount of the tax evaded.

In addition to major penalties, the auditor must evaluate the necessity to refer the taxpayer to the Office of Criminal Tax Investigations as well as evaluating the necessity of assessing reporting periods beyond the statute.

Sales Tax Accrual Overpayments

If during the examination the auditor determines that the taxpayer overpaid sales tax, a credit may be granted within the audit. Only overreporting of sales tax resulting from verifiable sales tax accrual errors, such as double posting or paying more than was actually collected or due, can be granted on a complete basis. Before granting the credit, the auditor should verify that the taxpayer did not receive a refund for the overreporting or reduce their tax liability in a subsequent period to offset the overreporting.

Taxed and Nontaxed Sales

Sales Taxed by the Taxpayer

During the examination of sales, the auditor should multiply taxable sales amount by the proper tax rate on a sampling of sales invoices to verify that the proper tax rate was used. If exceptions are found, the auditor should compute the proper tax rate for each sales transaction in the sales population examined. The additional taxable amount resulting from sales being taxed at less

than the proper rate should be recorded and included in the total deficient sales for the population examined (*whether sales were examined on a complete or test audit basis*).

The auditor should examine a sampling of sales transactions to verify that the taxpayer charged tax based on the incremental basis of tax for state and local sales tax pursuant to the bracket system outlined in **72 P.S. §7203** and **53 P.S. §12720.503**. Exceptions should be scheduled and included in the audit findings as additional taxable sales. The auditor should increase the sample to determine if the noted exceptions were isolated or recurring. If the exceptions are found to be recurring, the auditor should consider determining the additional tax due by use of an effective rate examination.

Sales Tax on Nontaxable Sales

During the examination of sales, it may come to the auditor's attention that the taxpayer was charging sales tax on nontaxable sales. When this occurs, the auditor should inform the taxpayer of the error. The auditor should document in the sales tax section of the audit narrative that the taxpayer was informed of the error and instructed on the proper tax disposition of the sales transactions involved.

First Time Audit

If a use tax liability results from transactions on which sales tax was erroneously charged, the error and the use tax exposure should be explained to the taxpayer. This is typically observed in audits of construction contractors where the contractor erroneously charges sales tax on nontaxable construction activities. The taxpayer should be informed that use tax will be assessed in subsequent audits on similar transactions. The auditor should document in the audit narrative that the taxpayer was informed. The auditor should indicate on the *Additional Headquarters Processing Request* form that the taxpayer should be sent a "Contractor's Letter".

Subsequent Audits

If during subsequent audits the taxpayer is found to still be charging sales tax on nontaxable sales on which the taxpayer is required to pay use tax, the auditor should verify that the taxpayer was informed of the proper payment of tax in the previous audit. If the taxpayer was informed, the auditor should assess use tax on those items. No offsetting credit for sales tax collected will be allowed.

Refund Of Tax Erroneously Collected

The taxpayer is not entitled to a credit or refund for the collection and payment of sales tax on a nontaxable sale, the customer is due the credit. The customer must apply to the Board of Appeals to recover this type of credit. If the taxpayer has refunded or credited the erroneously collected tax to the customer and the auditor can verify the refund or credit, the auditor may allow the credit on a first-time audit. The taxpayer should be informed of the proper method to recover this type of credit.

Sales Not Taxed by The Taxpayer

In examining nontaxed sales, there are four fundamental methods of audit examinations that may be employed:

- Complete
- Modified Complete
- Test
- Combination

In each of these methods of audits, the auditor must determine the taxability of each sale in the population examined. Each transaction occurring within the population is examined to determine whether the transaction was properly treated as a nontaxable transaction by the taxpayer either because the item is excluded or exempt from tax. Exemption certificates that support nontaxed transactions must also be examined for authenticity and validity.

Transaction Analysis

Sufficient analysis should be conducted of the nontaxed transactions to determine whether the taxpayer correctly treated the sale as a nontaxable sale. The auditor should determine if the sale is within Pennsylvania, are the products or services sold subject to tax, is there a purchase price or implied purchase price, is there a valid exemption certificate on file, or is a valid reason provided on an exemption statement if a certificate was not on file. The answers to these questions will determine if the taxpayer correctly treated the transaction as a nontaxable sale.

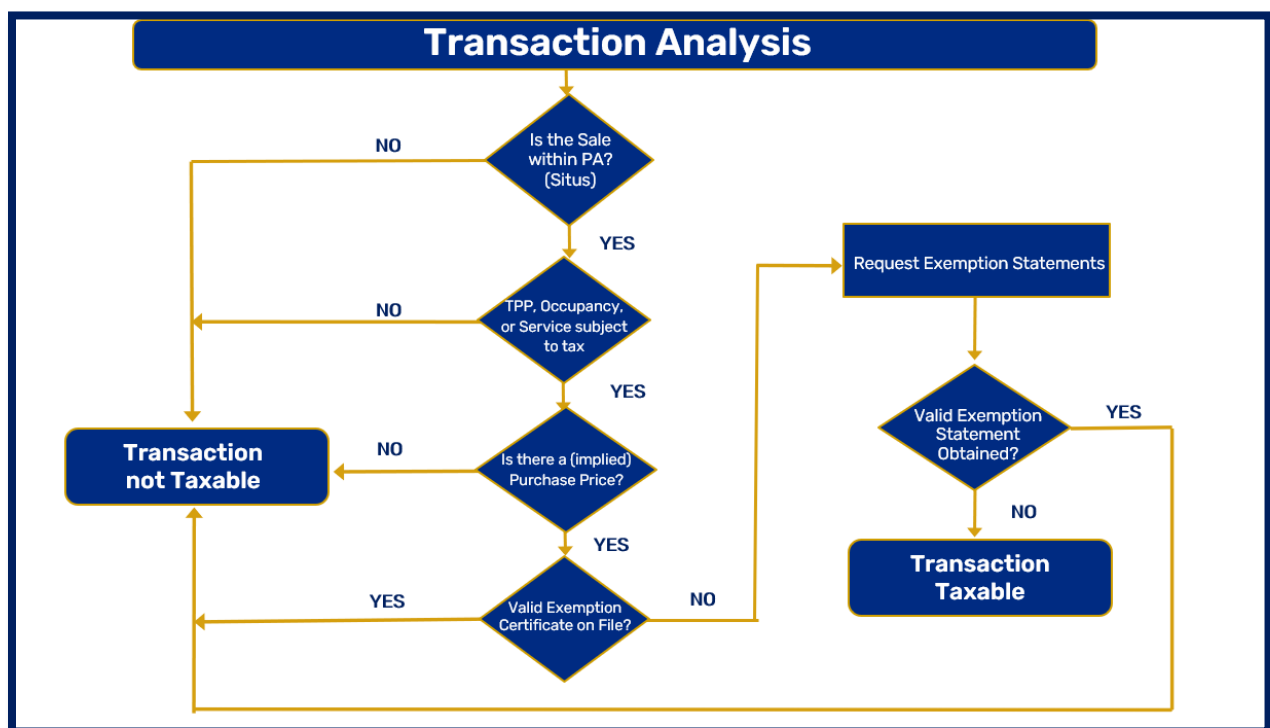


Figure 4.2: Transaction Analysis Flowchart

Items that were not properly taxed should be listed on a sales schedule in Bureau's audit application software. When the audit is submitted to headquarters, the sales should be included on a schedule that is formatted the same as the template schedule that is available in Bureau's audit application software. The detail of the items listed should include at a minimum: invoice/transaction date, invoice number, customer, item(s) sold, invoice amount, invoice taxable amount, tax charged, and additional taxable amount. The template schedule includes additional columns to record a reason code for a basis of assessment.

Exemption Certificates

When examining exemption certificates, the auditor must determine if there is a valid exemption available to the customer with respect to the item of property or service that is subject of the transaction and if there is a valid exemption certificate accepted in good faith on file for the transaction when applicable.

Acceptance In Good Faith

To be accepted in good faith an exemption certificate must:

- Be properly completed,
- Be in the seller's possession within 60 days from the date of the nontaxed sale.
- Not contain information, which is knowingly false, and
- The item or service sold is consistent with the exemption claimed and the purchaser's business activities.

The taxpayer is presumed to be familiar with the laws and regulations governing their business and their customers.

Invalid or Missing Exemption Certificates

A copy of the sales tax worksheet or schedule identifying all invalid or missing exemption certificates should be presented to the taxpayer along with a Request for Financial Records specifically requesting that the taxpayer solicit exemption statements from those customers whom the taxpayer believes to be exempt.

Exemption Statements

Exemption statements must be on the customer's letterhead, reference the invoice in question by date and invoice number, state what was purchased, the reason it is exempt (how it is used) and include a signature, title, and date. Exemption certificates cannot be considered as accepted in good faith in lieu of exemption statements unless the date of the certificate is within 60 days of the actual sale.

The taxpayer should be given 30 days to obtain statements. If the taxpayer does not obtain exemption statements or the statements provided are not complete or do not provide a valid reason for exemption, the transactions in question should be assessed the tax through the audit.

Missing Invoices or Source Documents

If the source document for the sale is not available for examination and an alternative means of determining if the item was subject to tax and/or tax was charged is not available, the auditor should list the transaction on the sales tax worksheet or schedule and indicate “invoice missing” in the description column. These items are presumed to be taxable until the taxpayer provides documentation to support that the item is not subject to tax or that the item was properly taxed at the time of the sale.

The taxpayer should be given a copy of the worksheet or schedule along with a Request for Financial Records, requesting that the taxpayer supply documentation supporting any items they believe should be removed from the worksheet prior to assessment. The form should reference the worksheet and include a date by which the documentation is needed (usually 30 days). The taxpayer should be asked to provide an explanation as to why the items are not available for examination. If additional information is needed to determine the proper treatment of the transaction if documentation is provided, such as an exemption statement, it should be requested at this time as well. A copy of the schedule given to the taxpayer should be included in the audit report as an attachment to the *Request for Financial Records* form or as a separate schedule that is referenced on the *Request for Financial Records* form.

Tax Self-Assessed by Customers

The Department’s position on removing items found to be deficient based on documentation furnished by the customer to the taxpayer is as follows:

- If the customer responds on the exemption statement that use tax was paid (by the customers). The customer must attest that the use tax was paid and provide their sales and use license number. The auditor should verify that the customer is registered for sales and use tax and did remit an adequate amount of use tax to cover the nontaxed items. This policy will apply whether a complete or test audit is performed. If the customer did not report sufficient use tax, an [audit referral](#) must be submitted via PATH.
- If the customer responds on the exemption statement that they (the customer) were audited for a period that contains the transaction(s) in question, it is necessary to confirm that an audit, was in fact, performed on the customer. The customer must supply their account number and the period for which they were audited. If the customer was audited for the period covering the transaction(s), the item(s) shall not be assessed in the audit of the seller and item(s) shall be deleted from the listing of assessed items. It is not necessary to verify that the specific item was assessed in the audit of the customer, only that the customer was audited for the period that contained the item(s) listed. The auditor is not required to verify that the assessment against the customer has been paid. This policy will apply whether a complete or test audit is performed on the seller.

Note: This policy differs from the policy regarding elimination of transactions when a use tax audit is performed.

Hotel Occupancy Tax

General

Hotel Occupancy tax is imposed upon every occupancy by an occupant of a hotel room, for rentals of a period fewer than 30 days. The tax is collected by the operator of the hotel at the time the rent is due. Unless there is evidence to the contrary, it is presumed that the rent is due at the expiration of the rental period. Because the tax is to be charged, collected, and remitted by the operator, there is no use tax provision for hotel occupancy tax.

Booking Agents

Effective January 22, 2019, a booking agent that facilitates an occupancy on behalf of an operator located in Pennsylvania must charge, collect, and remit hotel occupancy tax on the discount room charge, which is the amount charged by the hotel operator. In addition to hotel occupancy tax, the booking agent is required to register for a Booking Agent license. Booking agents are required to charge, collect, and remit hotel occupancy tax on any accommodation fee they charge. An accommodation fee is any amount charged by the booking agent in excess of the discount room charge. The hotel occupancy tax on the accommodation fee is reported on a Hotel Booking Agent Tax Return through myPATH. The tax on the accommodation fees is reported separately as the taxes collected are designated for state's Tourism Promotion Fund and not the General Fund as other sales, use, and hotel occupancy taxes.

Booking agents are required to pay hotel occupancy tax on their purchases of hotel occupancy from the operator. As there is no provision for resale for the hotel occupancy tax, the operator is required to charge, collect, and remit all applicable hotel occupancy taxes on their sales to the booking agent. The booking agent will then take a Taxes Paid – Purchases Resold (TPPR) credit on the PA-3, Sales, Use, and Hotel Occupancy Tax Return.

In instances where the booking agent collects the tax from unlicensed operators (e.g., private homeowners offering occupancy on an online marketplace), the hotel occupancy tax on the discount room charge is charged, collected, and remitted under the booking agent's hotel occupancy tax license. The booking agent is not entitled to the TPPR credit.

Link: [Hotel Booking Fact Sheet](#)

Exemptions

Many of the exemptions applicable for sales and use tax do not apply to the hotel occupancy tax. The exemptions allowed are listed in **61 Pa. Code § 38.2**. An exemption is not available to the following customers:

- Commonwealth of Pennsylvania, its instrumentalities, or political subdivisions
- State chartered credit unions
- Institutions of Purely Public Charity
- Those claiming a limited business exemption.
- Direct-Payment Permit Holders

Types of Hotel Occupancy Tax Audits

Concepts applied in the auditing of sales tax generally apply to hotel occupancy tax audits. A thorough working knowledge of the hotel occupancy tax and the rules and regulations promulgated, coupled with a complete understanding of the sales tax audit principles and techniques will enable the auditor to effectively perform hotel occupancy tax audits. Any hotel occupancy tax assessment must be separately identified in the audit report.

General

The following examination methods, which are employed in sales tax auditing, are adaptable to and generally utilized in hotel occupancy tax auditing:

- **Complete**
- **Modified Complete**
- **Test**
- **Combination**

The procedures, techniques, and forms employed in sales tax audits are utilized for state and local hotel occupancy tax audits except that occupancies are examined instead of sales.

The individual occupancy listings, which serve as the basis for the audit findings are recorded on the template in the Bureau's audit application software "Hotel Occupancy schedule". The details on the schedule include:

- **Check-In and Check-Out Date**
- **Invoice, bill, or folio number**
- **Name of the occupant**
- **Total rental value of the occupancy**
- **Taxable rental value of the occupancy**
- **Tax incurred on the taxable rental value.**
- **Tax charged on the occupancy.**
- **Reason the auditor considers the rental value as taxable where the taxpayer has considered nontaxable.**

Test Audits

When conducting a test audit on room revenues (occupancies), the population for choosing test periods for hotel occupancy will be different from the population used to determine the sales tax test period. This is necessary because sales tax and hotel occupancy tax operate under different exemption rules. Separate error rates and projections should be calculated for each area of tax. Two separate test forms are required. Sometimes taxpayers have monthly reports of tax-exempt rooms or separate folders for banquet/catering charges.

Use Tax

The auditor is to verify that the taxpayer self-assessed use tax on purchases of taxable tangible personal property and services that were not properly taxed by the vendor. In addition, the auditor must verify eligibility for the KOZ/KOEZ/SDA exemption where such exemption has been used to make nontaxed purchases. Contact HQ to verify the status of the taxpayer's KOZ/KOEZ/SDA exemption.

The use tax examination involves three distinct parts: Use Tax Accrual Verification, Capital Purchases Examination, and Expense Purchases Examination. Each of these parts must be clearly explained and documented in the audit report. The auditor must approximate the number of expense transactions per month to identify the most effective and efficient audit procedures to examine expenditures.

Use Tax Accrual

General

The auditor must establish the audit trail as it pertains to the accrual of state and local use tax and document the trail in the System Survey section of the audit narrative. The auditor must explain how the taxpayer identifies purchases not properly taxed by the vendor, how the use tax is calculated, how the use tax is accrued and reported, and how the taxpayer codes the invoice to indicate use tax was accrued.

A complete reconciliation of the state and local use tax per the books to the reported use tax is required for the audit period. The results of the reconciliation by jurisdiction must be detailed on the "Accrual Differences" schedule. When use tax is accrued from more than one source and errors are found in posting to the accrual account, a supplemental schedule detailing the amount from the various sources of use tax for each reporting period should be included in the audit report. The auditor should substantiate their findings by exhibiting the documentation used in identifying the errors.

A sampling of transactions where the taxpayer accrued use tax should be traced to the books and records used in the reporting of use tax to verify the accuracy of the reported use tax. Exceptions should be scheduled and included in the audit findings. If errors are found, the auditor should increase the sample to determine if the noted exceptions were isolated or recurring. If the exceptions are recurring, the auditor should not rely on the use tax coding on the source documents. A different audit approach is required to account for the use tax. Additionally, the auditor may encounter other situations which will also require a different audit approach to account for the use tax, such as:

- Material fluctuations in the amount of use tax reported throughout the audit period.
- Records are not made available to perform a reconciliation.
- Accounting system does not allow a way to effectively identify self-assessed transactions.
- Ability to trace adjustments from the use tax accrual account to the supporting documentation.

- Ability to segregate use tax reported on capital purchases from use tax reported on general expenses.
- Arbitrary or estimated amounts of reported use tax.

When the auditor encounters the above situations, they should identify all taxable transactions where the vendor did not properly charge sales tax and then offset any use tax due by the amount of the reported use tax. In these situations, a zero (0) is entered under the “Audited Tax Accrual” column for each reporting period. This credit of reported use tax will act as an offset to the actual use tax liability established and should be identified in the narrative as such.

Any use tax deficiency established by the auditor must be recorded on the “Accrual Differences” schedule by filing period. The auditor should support the summary use tax accrual deficiency amounts with transaction-specific schedules or exhibits. The nature of the use tax accrual deficiency should be fully explained in the narrative.

In addition, credits granted in the audit for use tax reported in error (use tax overpayment credits) should be detailed on a schedule and not shown as a reduction to the “Audited Tax Accrual” column of the “Accrual Differences” schedule.

Capital Purchases

General

A complete examination of capital purchases is generally required. When computerized records are available, a modified complete examination may be performed.

A listing of capital purchases acquired during the audit period should be included in the audit report as an exhibit and referenced in the narrative (i.e., a current depreciation schedule). The completeness of this list must be verified by reconciling the capitalized amounts to the general ledger; Schedule L, Balance Sheets per Books, or FF 4562, Depreciation and Amortization, of the federal income tax returns; and/or the RCT-106 of the PA Corporate Income Tax Returns. The auditor should trace all capital purchases from the capital purchase listing to the purchase invoices to verify the completeness of the purchase invoices presented for examination. Differences must be explained and reconciled.

The taxpayer should be given a schedule documenting the differences and a Request for Financial Records requesting that the taxpayer provide an explanation and documentation to support the differences. If documentation is provided that can be used to identify the source documents related to the differences, such as a journal entry, those documents should be reviewed as part of the examination. If material differences remain after the taxpayer has provided all additional information available, the auditor should assess use tax on the unsubstantiated differences. If the listing of capital purchases is higher than the summary records and no additional documentation is provided that can be used to determine if the assets were sold or otherwise disposed of that could be examined during the sales examination, a sales tax assessment should be issued on the difference.

When necessary, the taxability of a capital item should be determined by a physical inspection of the item while in use as well as an examination of supporting documentation. Supporting documentation includes purchase orders and capital expense requisitions.

Notes:

- When auditing a business claiming a business exemption, visual inspection of equipment during the plant tour is an integral part of this phase of the audit. Failure by the taxpayer to provide a plant tour in this scenario represents a scope limitation because the auditor cannot visually inspect how a piece of equipment is actually used in the manufacturing process.
- Transactions not properly taxed by the vendor should be traced to the use tax accrual account. Deficient transactions should be listed on the “Capital Assets” schedule. In addition to the information listed on the schedule, the basis for assessing use tax should be included. The taxpayer should be presented with the schedule and given an opportunity to review the deficient transactions and provide supporting documentation and explanations for those transactions that the taxpayer believes are not taxable or on which tax was paid.

Predominant Use

When the taxpayer uses a capital asset in both a taxable and nontaxable manner, the taxpayer must provide supplemental documentation that can be used to determine the predominant use of the item. The predominant use (more than 50%) determines the taxability of the item in question. The narrative should include an explanation of how predominance was determined, and the supplemental documentation should be included in the audit report when available.

Testing of Capital

When computerized records can be obtained for capital, a review should be made to determine if an efficient complete or modified complete examination of capital could be performed. If a complete or modified complete examination cannot be efficiently performed, a test of capital purchases may be performed in certain circumstances. If the taxpayer can provide a verifiable computerized listing of all capital purchases that are able to be examined using a stratified random sample methodology, the regional office may contact the Sales and Use Tax Program Administrator to discuss a test of capital.

Expense Purchases

General

In examining expenses, there are four fundamental methods of audit examinations that may be employed:

- Complete
- Modified Complete
- Test
- Combination

In each of these types of audits, the auditor must determine the taxability of each expense transaction within the defined population. Each transaction occurring within the population is

examined to determine whether the proper amount of tax (tax incurred) has been charged by and remitted to the vendor or that use tax was accrued and reported on taxable transactions. The auditor must approximate the number of expense transactions per month and identify how the approximation was determined.

When a test audit is performed, the auditor should review the taxpayer's chart of accounts and general ledger to identify accounts that have a large dollar amount and include a small number of transactions. Accounts with large dollar amounts and a relatively small number of transactions should be removed from the test population prior to the selection of the test period(s) and examined on a complete basis. Examples of such accounts include utilities, prepaid accounts, lease payments, and telephone accounts.

The auditor should verify that all source documents were made available for examination by tracing a sampling of transactions in the original books of entry (i.e., disbursements journal or accounts payable journal) to the source documents. The auditor should also trace a sample of source documents to the original books of entry to verify the transactions were properly recorded. This sample should be traced to the disbursements journal to verify sales tax charged on the invoice was actually paid by the taxpayer. Exceptions should be addressed in the audit report and assessed when deficiencies are discovered.

All transactions in the population chosen for examination should be examined to determine if the vendor charged sales tax on all taxable purchases. Transactions not properly taxed should be traced to the use tax accrual account to determine if use tax was reported. Deficient transactions should be listed on the "Expenses" schedule.

In making the determination of the taxability of the items examined, the auditor may, in addition to examining the purchase invoices, examine other supporting evidence such as purchase orders, account coding, contracts, and physical inspection of the items in use. When the auditor relies on supporting documentation to determine the taxability of an item, the documentation should be referenced in the audit narrative and on the "Expenses" schedule. A copy of the chart of accounts, purchase orders, contracts, or other supporting documentation should be included in the audit as exhibits when they are necessary to support the deficient transactions listed on the "Expenses" schedule.

Construction Materials

In cases where a taxpayer is engaged in the performance of a construction activity, the auditor is to conduct a complete examination of all job-related material expenses. Job related expenses must be examined and discussed separately from other expenses in the audit narrative.

When computerized records can be obtained for materials and supplies used in construction activities, a review should be made to determine if an efficient complete or modified complete examination of job-related expenses can be performed. If a complete or modified complete examination cannot be efficiently performed, a test of job-related expenses may be performed in very limited circumstances. If the taxpayer can provide a verifiable computerized listing of all job-related purchases that are able to be examined using a stratified random sample methodology, the regional office may contact to Sales and Use Tax Program Administrator to discuss a test of job costs.

Use Tax Credits Recognized by Auditors

General

The auditor may grant credits in an audit for:

- Use Tax Overpayments
- Taxes Paid-Purchases Resold
- Third Party Credits

These credits may be granted for all periods covered in an audit.

Verifying Prior Credits

Prior to granting credit within any audit, the auditor must review RAPS to determine if the taxpayer received a refund during any portion of the audit period. If file documents are not available on RAPS, then headquarters personnel should be contacted to obtain the file.

Auditor's Responsibility for Developing Use Tax Credits

The auditor will make a reasonable effort to develop use tax overpayments rightfully due the taxpayer. However, the auditor will not expend excessive time in verifying or developing overpayments. In situations where an excessive amount of time is involved in such work, the auditor will request the taxpayer to develop the necessary documentation supporting the overpayments and the auditor can include these credits in their report after verifying its accuracy and completeness.

If the taxpayer is unable to provide this information by the conclusion of the audit or any credits requested by the taxpayer are denied, the auditor should inform the taxpayer that the statute of limitations for any transaction within the audit period is six months from the date of the *"Notice of Assessment"* or three years from the date the tax was paid, whichever is later, and that it is necessary to file a petition for refund for any credits not granted in the audit. These petitions must be supported by sufficient documentation that proves the overpayment of tax.

Supervisory Review

When the auditor is granting credits to the taxpayer during the audit, the supervisor should review the credits during the audit [pre-review](#).

Use Tax Overpayments

Credit for use tax overpayments will be recognized in the audit. This situation arises when the taxpayer self-assesses use tax on a purchase that is excluded or exempt from the tax. Before granting the credit, the auditor should verify that the taxpayer did not receive a refund for the overpayment or reduced their use tax liability in a subsequent period to offset the overpayment.

When a test period for expenses is selected on a representative basis using key characteristics, credits for use tax paid directly to the Commonwealth will be included in the numerator of the

error rate. As outlined in **61 Pa. Code §8a**, “Enforcement”, if the results of a representative sample (block sample or Stratified Random Sample) yield a net credit, a credit will be projected for the reporting periods represented by that test sample.

Use tax overpayment credits will be projected when:

- The test periods are chosen on a representative basis (i.e., average expenses) as outlined in §8a, and
- A stratified random sample methodology is utilized, and the number of observations results in a precision mutually agreed upon by the Department and the taxpayer, or
- Block sample test periods are selected using one reporting period per year or one complete year within the audit period, and
- Use tax reporting is consistent throughout the audit period.

Credits should not be projected when the test periods were selected based on the unavailability of records. This requirement may be waived if the records for a substantial portion of the audit period are available, and the sample(s) selected is chosen as representative from those periods that are available. When records are not available for the entire audit period, regional manager approval is required prior to projecting the results of a net credit test period.

A separate schedule must be included within the audit report for any requested use tax overpayment credits that were denied by the auditor. The reason for denying the credit must be included on the schedule.

Taxes Paid-Purchases Resold Credit

Credit for Taxes Paid on Purchases Resold (TPPR), as explained in **61 Pa. Code § 58.11**, will be recognized in the audit. This situation arises when the taxpayer pays tax on tangible personal property included in inventory, which has been resold in the ordinary course of business. TPPR credits may be reported on the sales and use tax return or requested through the audit. Any TPPR credits reported on the sales and use tax return must be verified by the auditor. The taxpayer should develop any TPPR credits they are requesting to be included in the audit.

To verify the reported or requested TPPR credits, the taxpayer must provide proof that sales tax was paid on the original purchase, an invoice, or similar source document, showing the sale of the item in question, and an attestation on company letterhead. The attestation must state that they have verified that the credit was not previously received through a credit memo, petition for refund, or any other means and be signed by the taxpayer, a corporate officer, or a holder of power of attorney.

Credit for taxes paid on purchases resold may only be granted on a complete basis and may not be included in an audit assessment as a projection. These credits reduce the overall use tax liability.

Any TPPR credit granted should be listed on the “TPPR Credits” schedule.

Reported TPPR credits that were disallowed by the auditor must be documented on a separate schedule and assessed through the audit.

Third Party Credits

If an auditor discovers that during the audit period, the taxpayer overpaid tax to a vendor and the taxpayer provides sufficient evidence to the auditor that the tax is not rightfully due the Commonwealth, the auditor will be permitted to grant credit for the sales tax overpaid on that transaction. This is called a “third party credit”.

Credit for taxes paid erroneously to vendors must be granted in the sales and use tax audit if it can be established through clear and convincing documentary evidence that the taxpayer has paid the tax in error and the taxpayer has not received credit for the overpayments through any other means.

The *Requirements for Audit Review of Third-Party Credits* form should be presented to the taxpayer at the pre-audit conference. All documentation as outlined on this form must be presented by the taxpayer prior to issuing a third-party credit. The required documentation includes:

- A copy of the source document for the transaction
- Proof of tax payment
- A valid reason for exemption with supporting documentation if needed (i.e., predominant use study)
- An attestation that no credit memo, tax refund, or any similar reimbursement for tax overpayment was provided on the taxpayer’s letterhead and signed by the taxpayer, a corporate officer, or a holder of power of attorney.

If insufficient evidence is submitted to the auditor, the auditor must deny the credit.

Third party credits are only to be projected when using a stratified random sample methodology. The population used to select the sample must be drawn from the entire audit period. Exceptions must be approved by the Sales and Use Tax Program Administrator. Third party credits may not be projected in a block sample.

Any third-party credit granted outside of a stratified random sample should be listed on the “Third Party Credits” schedule. A separate schedule must be included within the audit report for any third-party credits denied by the auditor. The reason for denying the credit must be included on the schedule.

Whenever a third-party credit is granted for sales tax paid erroneously on a construction activity, the auditor should refer the schedule of related credits to headquarters through an *Additional Headquarters Processing Request* form with examples of transactions in question. Headquarters will review the vendors for possible audit or ask Office of Chief Counsel to write the contractor advising them to stop collecting sales tax and pay use tax on materials consumed in performing the construction activity.

Other Use Tax Consideration

Missing Invoices

The auditor should present the taxpayer with a list of transactions where an invoice was not provided for examination. A separate list should be prepared for capital and expense transactions. These lists should be labeled as “missing invoices” and should be included with a *Request for Financial Records* form. This form should specifically request the taxpayer provide the invoices for these transactions within a reasonable timeframe (typically 30 days). The list along with a *Request for Financial Records* form must be included in the audit report as documentation for any assessment of missing invoices.

Local Use Tax

The auditor should examine purchase invoices to determine if local sales tax was properly charged on all taxable purchases originating from vendors located in counties that impose a local sales tax or shipped to a taxpayer’s location within a county that imposes a local sales and use tax. The auditor should examine the taxpayer’s local use tax accrual records to determine if local use tax was accrued and reported on all purchases subject to the local tax where the vendor did not charge the local sales tax. Any deficient transactions should be listed on the appropriate “Capital Assets”, or “Expenses” schedule and the appropriate local tax box should be checked. It is possible that a transaction may have the appropriate amount of state sales tax charged. In these cases, the “State Exempt” box should be checked on the schedule. In cases where the taxable amount for state and local differ, the transaction will need to be entered on separate lines on the schedule.

Procurement/Purchase Cards

Procurement/purchase cards (P-Cards) allow authorized employees to purchase goods and services using a company credit card without using the traditional purchasing process. Usually there is a limit on the maximum single purchase, the accounts or cost centers for which it may be used, or the types of items that may be purchased using the card.

Some common audit issues regarding the use of P-cards include:

- A purchase order is not used.
- The monthly lump sum payment made to the credit card company is for multiple purchases to multiple vendors and does not include transactional level detail necessary for audit purposes.
- Vendor source documents identifying an item description, purchase price, and sales tax charged are not often maintained or readily accessible.
- A single payment may be assigned to several accounts and cost centers.
- Organizations are replacing checks with purchasing cards and automating the payment to the supplier, complicating proof of payment related to the individual purchases.

The auditor should review the taxpayer's purchasing methods and determine if separate audit procedures are necessary to examine these transactions prior to defining the population for selecting test period(s).

The audit narrative must specifically address the taxpayer's use of procurement cards and the audit procedures used in their examination.

Electronic Data Interchange

Electronic Data Interchange (EDI) is where transactions only exist in electronic or computerized form. In these situations, the taxpayer does not maintain paper copies of invoices to support the transactions recorded in the taxpayer's books.

The invoice detail such as invoice number, invoice date, merchandise, invoice amount, sales tax, etc. typically listed on a hard copy of an invoice is recorded electronically in the taxpayer's books resulting in a "paperless" exchange.

If any of the population examined by the auditor includes EDI transactions, a list of taxable EDI transactions where sales tax was paid to the vendor should be provided to the taxpayer. A separate list should be prepared for each vendor. A statement must be obtained from the vendor on their letterhead indicating they are registered (provide account number) with the Department of Revenue and the sales tax for the listed transactions was reported and remitted to the Department. The list and the request for a statement from the vendor must be documented on a *Request for Financial Records* form.

Tax Added to Nontaxed Purchase Invoices

In situations where a taxpayer indicates that sales tax was manually added to a purchase invoice and paid to the vendor, the auditor must verify the supporting documentation. The auditor should verify that the tax was actually added to the invoice and paid to the vendor. In addition, the vendor must furnish their applicable sales tax accrual record (or excerpt) or sales tax accrual worksheet showing the items in question, their account number, and the period(s) when it was reported to be acceptable. The auditor should verify that the vendor is registered for sales and use tax and did remit sales tax adequate to cover the transactions in question.

Tax Assessed on Vendor

If the taxpayer claims that a deficient transaction was assessed in an audit of the vendor, it is the taxpayer's responsibility to obtain the sales tax license number, employer identification number, and audit period from the vendor. The auditor will then corroborate the information provided by examining internal records.

If the vendor was audited on a complete basis and the same deficient transaction was assessed in the audit of the vendor, and the vendor paid the assessment, the deficient transaction should be deleted from the schedule.

If the vendor was audited on a test basis and the test population included the deficient transaction, the deficient transaction will be deleted from the schedule if the vendor paid the assessment.

Note: This differs from the sales tax audit policy.

Conducting Plant Tours

If the taxpayer is in the business of manufacturing, processing, or mining, it is imperative to tour their operations before proceeding with the examination of records due to the limited business exemption. This will allow the auditor to verify the taxpayer's operations or activities qualify for the business exemption and to identify the first and last stages of their operation.

Procedures

Before the Tour

- Request a complete capital asset listing from the taxpayer.
- Ask the taxpayer to provide a detailed narrative of the operation including hours of operations and if any scheduled plant shutdowns occurred during the audit period.
- Obtain a listing of the utility meters for electricity and natural gas to see what areas, if any are separately metered.

Note: On-road diesel fuel (clear) is subject to fuels tax and **not** subject to sales tax. Off-road or dyed low sulfur diesel is subject to sales tax unless supported by an [Pennsylvania Exemption Certificate \(REV-1220\)](#).

During the Tour

- Identify the first and last stage of the operation as well as the type of property being used in pre- and post-production areas.
- Using the capital listing, identify where in the operation the property is being used and determine direct use (nontaxable) or indirect use (taxable).
 - For assets purchased outside of the audit period, identify where in the operation these assets are being used so a determination may be made when reviewing expenses associated with these assets.
- Identify activities not qualifying as manufacturing processing or mining such as repair and maintenance shops.
- For property used in a taxable and nontaxable manner such as forklifts, request the taxpayer provide a usage study to determine predominant use.
- Trace a few assets from the capital asset listing to the physical asset to verify the completeness of the capital asset listing.

E-911 PEMA

The auditor should be familiar with the business activities of the taxpayer and verify that E-911 surcharged is being charged, collected, and remitted on all wireless telephones or pre-paid telecommunication services (i.e., pre-paid cell phone minutes or phone cards). The E-911 fee is \$1.65 per transaction through February 29, 2024, and \$1.95 thereafter.

Reported and audited E-911 surcharges are included on the “Accrual Differences” schedule created by the import process in the Bureau’s audit application software. This schedule is included in every sales and use tax audit report and referenced in the audit narrative. All unreported E-911 surcharges must be recorded in the audit report on this schedule.

For audit purposes, the auditor should request the E-911 general ledger accrual account, sales journal summarizing the E-911 fees charged and collected or any other sales report detailing the E-911 fees charged and collected during the audit period. The auditor should trace the amounts from the taxpayer’s books to the E-911 fees listed in the “Accrual Difference” schedule.

If discrepancies are found, the auditor should prepare a schedule and include it in the audit report to document accrued amounts not included in the reported surcharge amounts. The “*Audited Tax Accrual*” amounts on the “Accrual Differences” schedule should be adjusted to reflect the auditor’s findings. Additionally, the source of the adjustment should be included as an exhibit in the audit report.

Note: The Department is prohibited from assessing the surcharge on the sales of wireless devices or prepaid telecommunication services where the vendor failed to charge/collect the surcharge. In these situations, the auditor should instruct the taxpayer to begin charging and collecting the surcharge.

If the auditor is unable to perform a reconciliation of accrual amounts, a statement should be included in the narrative indicating as such.

Public Transportation Assistance Tax and Fees

The auditor must be familiar with **61 Pa. Code §47.19**, Public Transportation Assistance Taxes and Fees (PTA). The auditor should be familiar with the exemptions and exclusions available for PTA taxes and fees and how they differ from the exemptions and exclusions available for sales and use tax.

Minimum Requirements

For any taxpayers registered for PTA, the following must be conducted during the sales and use tax audit:

Note: Reference to these requirements should be included in the “*Areas of Discussion*” section of the audit narrative.

PTA Audited vs. Reported

The auditor must review PATH to determine if the taxpayer is registered for PTA tax. If the taxpayer was registered for PTA anytime during the sales and use tax audit period, the auditor must obtain reported PTA amounts for all quarters within the statute of limitations. The auditor must verify that all accrued PTA taxes and fees (tire fee, rental fee, and lease taxes) are included in the quarterly reported amounts. This verification should include accruals due to sales to

customers and accruals due to taxes and fees not paid to the vendors. The audit report must include a PTA Accrual Difference schedule to document that these procedures were performed. If a deficiency results from this verification, a separate PTA audit must be conducted. If an overpayment is discovered, the taxpayer should be advised of the overpayment and procedures to obtain a refund.

PTA Sales Examination

When a taxpayer's business activities include selling tires, leasing vehicles, or renting vehicles, the population examined for sales tax purposes should also be examined to determine if applicable PTA taxes and fees are being properly charged to customers consistent with **61 Pa. Code §47.19**. In addition, any sales transactions involving the sale of new vehicles should be examined to determine the tire fee for each new tire was properly charged and accrued. If the taxpayer is not charging taxes or fees on taxable transactions, a separate PTA audit must be conducted.

PTA Expenses Examination

During the use tax portion of the audit, the population examined for expenses should also be examined to determine if the proper taxes and fees were charged by the vendor on the purchase of tires, leases of vehicles and rental of vehicles consistent with **61 Pa. Code §47.19**. If the taxpayer is registered for PTA, a sample of transactions where taxes or fees were not properly charged by the vendor should be traced to the PTA accrual account to determine if PTA tax was properly self-assessed. If deficiencies are found, a PTA audit is required.

Nonregistered Taxpayers

If deficiencies are found and the taxpayer is not registered for PTA, the auditor must instruct the taxpayer to register for a PTA license number online at [myPATH](#).

Obtaining Reported PTA Information

PTA taxes and fees are reported on a quarterly basis. Reported amounts for each complete quarter within the statute of limitations should be obtained and compared to the taxpayer's recorded amounts.

Reported PTA information is maintained within PATH under the Accounts tab in the Customer Springboard. The auditor will generate a [PTA Download](#) of the reported amounts to include on the "PTA Accrual Difference" schedule with the Bureau's audit application software.

PTA Audit Assignments

The overall audit procedures and documentation requirements regarding the conduct of a PTA audit are the same as those required for a sales and use tax audit assignment. Exceptions and procedures specific to PTA audit assignments are explained below.

PTA audits will be designated an assignment number beginning with PTA (Public Transportation Assistance) prefix. PTA audit assignments should be conducted concurrently with the sales and

use tax audit assignment. The information necessary for an assessment of PTA taxes and fees should be captured using the templates specific to PTA assignments in Bureau's audit application software. The same population examined for the sales and use tax review is generally used for the examination of PTA taxes and fees.

Audited vs. Reported Amounts

The audit trail for taxes and fees should be documented in the audit narrative. The auditor should verify that all PTA taxes and fees accrued were properly reported on the PTA returns for each reporting period in the audit period. The auditor should prepare a "PTA Accrual Differences" schedule, as per the [PTA Download](#) instructions. This schedule shall segregate and compare the audited and reported amounts by motor vehicles lease tax, motor vehicle rental fee, and tire fee.

The lease tax, rental fees, and tire fees are each assigned unique tax codes and schedule templates in the Bureau's audit application software. Therefore, assessment of any one or all of these PTA taxes and fees may be assessed through a single PTA assignment.

When there is more than one source for a particular tax or fee (lease, rental, or tire) the auditor should prepare a schedule listing the individual sources to verify that all sources were included in the amounts reported.

A sample of PTA taxes and fees that were charged on sales invoices should be traced to the books of original entry to verify that taxes and fees were properly recorded in the PTA accrual accounts. The sample should also be examined to verify that vehicle lease tax, rental fees, and tire fees were charged at the appropriate rate.

Sales Subject to PTA

Each transaction examined during the sales tax phase of the collateral sales and use tax audit should be examined to verify that the proper taxes and fees were charged. When the proper tax or fee was not charged to the customer, exemption certificates should be examined to determine if a proper exemption certificate is on file. Deficient transactions should be listed on the appropriate PTA sales schedule template in the Bureau's audit application software with specific tax code to indicate the type of taxes and fees applicable. The schedule templates can be found in the "Schedule Template Files (PTA)" in the Bureau's audit application software.

Lease Tax

Lease tax examinations are generally conducted on a complete or modified complete basis. Test audit procedures may be used when the auditor can document that conducting a complete audit is unduly burdensome due to the number of transactions and that conducting a modified complete audit is impractical due to the substantial changes in the leasing customers over the audit period.

Rental Fee

Rental fee examinations should generally be conducted on a complete or modified basis.

Test audit procedures may be used in limited circumstances. Because the rental fee is based on daily rentals, the auditor must know the total number of rental days for each vehicle rented to properly conduct a test audit procedure.

The rental days on which the rental fee was not charged should be divided by the total rental days within the test period (ratio).

Note: It is possible that “*rental days*” could differ from calendar days in the test period. The ratio should then be multiplied by the total rental in each reporting period to determine the projected deficient rental days. The results should be multiplied by \$2.00 to compute the rental fee deficiency by reporting period.

If the taxpayer does not make the records available to perform a complete, modified complete, or test audit procedure as explained above, the auditor should specifically request the necessary records that were not made available on a *Request for Financial Records* form. The auditor may then use the available records to compute a ratio of rental tax to sales (or deficient rental days to sales) and apply the ratio to sales in the remainder of the audit period to compute the projected deficient rental fee.

Tire Fee

Tire fee examinations should generally be conducted on a complete or modified complete basis.

Test audit procedures may be used in limited circumstances. The tire fee is based on the number of new tires sold for over the road use. To properly conduct a test audit procedure, the auditor must know the total number of new tires sold in each reporting period.

The total number of new tires found to be deficient in the test period should be divided by the total number of new tires sold during the test period (ratio). The ratio should then be multiplied by the total number of new tires sold in each of the unexamined reporting periods to determine the total number of new tires subject to the tire fee. The results should be multiplied by \$1 to compute the tire fee deficiency by reporting period.

Another reasonable projectable basis may be used for the computation of the tire fee (e.g., the number of new cars sold multiplied by 5) when the exact number of tires sold cannot be determined. Sales dollars should not be used to project the tire fee unless the number of tires sold cannot be determined.

If the taxpayer does not make the records available to perform a complete, modified complete, or test audit procedures as explained above, the auditor should specifically request the necessary records that were not made available on a *Request for Financial Records* form. The auditor may then use the available records (usually the same period as the sales tax examination) to compute a ratio of deficient tire tax to sales (or deficient number of tires to sales). The computed ratio is then applied to sales for the remainder of the audit period to compute the projected deficient tire fee.

For the convenience of the taxpayer, this procedure may be used when the taxpayer provides a signed written request.

Expenses Subject To PTA

The expense population examined during the sales and use tax audit should also be examined to verify that that vendor properly charged all applicable PTA taxes and fees. Exceptions should be traced to the taxpayer's PTA accrual account to determine if tax or fees were self-assessed. Transactions found to be deficient should be listed in the Bureau's audit application software indicating the proper taxes and fees applicable.

Type of Examination

Examination of purchases for the proper payment of applicable taxes and fees should be conducted on a complete or a modified complete basis.

When a complete examination was made of expenses during the concurrent sales and use tax audit, a complete audit should be conducted on the same population for PTA taxes and fees.

When a test audit is performed on expenses during the concurrent sales and use tax audit, a modified complete audit should be conducted on PTA taxes and fees. Generally, very few vendors will be found not properly charging PTA taxes and fees. The taxpayer should be given a [Request for Financial Records](#) specifically requesting a vendor history and purchase invoices for those vendors found to be deficient during the test period.

Vehicle Rental Tax

The auditor should be familiar with 61 Pa. Code §47.20, Vehicle Rental Tax (VRT), the exemptions and exclusions available for VRT, and how they differ from the exemptions and exclusions available for sales and use tax.

Minimum Requirements

For any taxpayers registered for VRT, the following must be conducted during the sales and use tax audit:

Reference to these requirements should be included in the "*Areas of Discussion*" section of the audit narrative.

VRT Audited vs. Reported

The auditor must review PATH to determine if the taxpayer is registered for VRT tax. If the taxpayer was registered for VRT during any period within the sales and use tax audit period, the auditor must obtain reported VRT figures for all quarters within the statute of limitations. The auditor must verify that all accrued VRT tax are included in the quarterly reported amounts. This verification should include accruals due to sales to customers and accruals due to taxes not paid to vendors. The audit report must include a "VRT Accrual Differences" schedule to document that these procedures were performed. If a deficiency results from this verification, a separate vehicle tax (VRT) audit must be conducted. If an overpayment is discovered, the taxpayer should be advised of the overpayment and procedures to obtain a refund.

VRT Sales Examination

When a taxpayer's business activities include renting five (5) or more vehicles, the auditor should verify that vehicle rental tax has been properly charged at a rate of 2% on all rental contracts of 29 days or less. The verification that the rental tax was properly charged should be conducted on source documents concurrently with the sales and use tax examination. When the taxpayer has been found not to be properly charging VRT on vehicle rentals, a VRT audit should be requested and conducted.

VRT Expenses Examination

During the use tax portion of the audit, the population examined for expenses should also be examined to determine if vehicle rental tax was properly charged on the rental of vehicles consistent with **61 Pa. Code §47.20**. If the taxpayer is registered for VRT, a sample of transactions where taxes or fees were not properly charged by the vendor should be traced to the VRT accrual account to determine if VRT tax was properly self-assessed. If deficiencies are found, a VRT audit is required.

Nonregistered Taxpayers

If deficiencies are found and the taxpayer is not registered for VRT, the auditor must instruct the taxpayer to register for a PTA license number online at [myPATH](#).

Obtaining Reported VRT Amounts

VRT returns are filed on a quarterly basis. Reported amounts for each complete quarter within the statute of limitations should be obtained and compared to the taxpayer's book amounts.

Reported VRT information is maintained within PATH under the Accounts tab in the Customer Springboard. Reported amounts can be downloaded using the instructions for [VRT Download](#).

VRT Assignments

The overall audit procedures and documentation requirements regarding the conduct of a VRT audit are the same as those required for a sales and use tax audit assignment. Exceptions and procedures specific to VRT audit assignments are explained below.

VRT audits will be designated an assignment number beginning with a VRT (Vehicle Rental Tax) prefix. VRT audit assignments should be conducted concurrently with the sales and use tax audit assignment.

The information necessary for an assessment of VRT should be captured in Bureau's audit application software using the schedule templates specific to VRT assignments. The same population examined for the sales and use tax review is generally used for the examination of VRT.

Audited vs. Reported

The audit trail for VRT should be documented in the audit narrative. The auditor should verify that all VRT taxes accrued were properly reported on the VRT returns for each reporting period in the audit period. The auditor should prepare a “VRT Accrual Differences” schedule, as per the [VRT Download](#) instructions. This schedule shall compare the audited and reported amounts.

A sample of VRT taxes that were charged on sales invoices should be traced to the books of original entry to verify that taxes were properly recorded in the VRT accrual account. The sample should also be examined to verify that the VRT tax was charged at the appropriate rate.

Sales Subject to VRT

The examination of the proper charging of VRT on sales transactions may be conducted on a complete, modified complete, or a test basis.

Test audit procedures may be used on the sales transactions when the auditor can document that conducting a complete audit is unduly burdensome or the records necessary to conduct a complete or modified audit were not made available. The test periods(s) should be selected based on average total vehicle rental sales. The auditor should specifically document that total vehicle rental sales for each reporting period in the audit period were requested by presenting the taxpayer with a *Request for Financial Records*.

The proper population to examine when verifying that vehicle rental tax was properly charged is total vehicle rental sales. The auditor should attempt to obtain the total vehicle rental sales by reporting period for the audit period. Other sales populations that include total vehicle rental sales may be used for the selection of the test period (and projection of test period findings to the remainder of the audit period) when the taxpayer does not make the total vehicle rental sales available.

The source documents within the population should be examined to determine if the VRT was properly charged on all taxable vehicle rental sales. A properly executed exemption certificate should be examined for all untaxed vehicle rental sales.

The auditor should give the taxpayer an opportunity to obtain an exemption statement or other documentation to support the exemption or proper payment of tax on any transaction listed on the schedule.

Any deficient transactions should be listed on the “Sales – Rental Tax” template schedule which can be found in the “Schedule Template Files (VRT)” within the Bureau’s audit application software.

Expenses Subject to VRT

The examination of the proper charging of VRT on expense transactions may be conducted on a complete or modified complete basis. Generally, a modified complete examination should be conducted. Vendors identified not properly charging vehicle rental tax during the examination of expenses in the use tax phase of the concurrent sales and use tax audit should be listed. The list, along with a Request for Financial Records requesting a vendor history and the expense invoices for those vendors for the audit period, should be presented to the taxpayer.

A test audit should not be conducted when examining expense transactions for proper VRT unless the information regarding vendors found to be deficient during a sample period is not made available for the remainder of the audit period.

The invoices should be examined, and any transactions identified as deficient should be listed on the “Expenses – Rental Tax” template schedule which can be found in the “Schedule Template Files (VRT)” within the Bureau’s audit application software.

Employer Withholding of Pennsylvania Personal Income Tax

The statute of limitations for employer withholding of Pennsylvania personal income tax (EW) is three years from the date the return is filed (rolling statute) and will most likely differ from the sales and use tax audit period. Therefore, the EW examination should be conducted as soon as practical during the sales and use tax audit since EW has a rolling statute. In situation where the auditor anticipates that the sales and use tax audit will take several months to complete, the auditor should attempt to complete the EW portion of the audit within 60 days of the pre-audit conference to avoid losing periods due to the statute of limitations.

Minimum Requirements

There are three minimum employer withholding requirements that must be conducted and documented in every sales and use tax audit report: comparison of W2 to the W3, verify taxes withheld were properly reported, and verify taxes were properly withheld on all taxable compensation. In addition, when audits are performed on partnerships or S corporations, the auditor is required to verify that tax was paid on behalf of nonresident principals. Tax issues relating to resident principals may be addressed through the issuance of a personal income tax (PT) audit. Names and social security numbers of principals must not be disclosed in a sales and use tax audit.

Reference to these requirements should be included in the “Areas of Discussion” section of the audit narrative.

W-2 to W-3 Reported Amounts

A general list of payroll records includes payroll registers or journals, W-2’s and transmittals (REV-1667) along with PA W-3. The W-2’s, Wage and Tax Statement are filed by employers to report wages, tips and other compensation paid to employees as well as FICA and withheld income taxes. The [Annual Withholding Reconciliation Statement \(REV-1667\)](#) along with W-2/1099 for each employee/distribution recipient must be submitted annually on or before January 31st following the year in which wages were paid or distributions occurred. The PA W-3, Employer Quarterly Reconciliation Return of Income Tax Withheld is used to reconcile the employer withholding payments during the quarter.

The auditor should verify that the sum of the reported W-3 tax reconciles to the tax as reported on the W-2 transmittal (REV-1667) for each year of the audit period.

A comparison of the reported W-3 taxes to the reported W-2 tax for each corresponding year must be documented on the *Employer Withholding Reconciliation* schedule. This schedule can be found in the “Schedule Template Files (WTH)” within the Bureau’s audit application software. The *Employer Withholding Reconciliation* schedule is required to be included in the sales and use tax audit report and must be referenced in the audit narrative.

If exceptions are found, the taxpayer should be given a *Request for Financial Records* form and a copy of the schedule. The taxpayer should be asked to submit documentation and explain the exceptions noted on the schedule.

After the auditor reviews the documentation submitted by the taxpayer, the following actions should occur:

- If the exception was the result of the over reporting of tax withheld as reported on a W-3 and the auditor verified the correct amount of tax withheld as per the taxpayer’s payroll records reconciles to the tax as reported on the W-2, the auditor should inform the taxpayer to file an amended W-3R through myPATH. The amended returns should be verified by the auditor in PATH and documented in the audit narrative. The auditor should follow up with the taxpayer if the amended returns were not filed.
- If the exception results from the incorrect amount of tax being reported on the [Annual Withholding Reconciliation Statement \(REV-1667\)](#) and the correct amount of tax withheld as per the taxpayer’s payroll records reconciles to the tax as reported on the W-3s, the auditor should inform the taxpayer to file an amended REV-1667 via myPATH. The amended “*Annual Withholding Reconciliation Statement (REV-1667)*” should be verified by the auditor in PATH and documented in the audit narrative]. The auditor should follow up with the taxpayer if the amended “*Annual Withholding Reconciliation Statement (REV-1667)*”.
- If the exception was the under-reporting of the tax withheld as reported on the W-3 and the correct amount of tax withheld as per the taxpayer’s payroll records reconciles to the W-2 transmittal, an employer withholding deficiency has been identified. A separate employer withholding audit assignment is required.

Note: Taxes withheld from employee’s compensation are considered trust fund monies. The statute of limitations does not apply to trust fund monies withheld and not reported.

Audited vs. Reported Amounts

The auditor should verify that the tax withheld per the taxpayer’s payroll records reconciles with the tax reported on the W-3 for each reporting period of the audit.

A comparison of the reported tax as per the W-3 to the tax withheld as per the taxpayer’s payroll records for the entire audit period must be documented on the [EW Accrual Differences](#) schedule. This schedule can be found in the “Schedule Template Files (WTH)” within the Bureau’s audit application software. This schedule is required to be included in the sales and use tax audit and must be referenced in the audit narrative.

If the taxpayer has over reported tax as verified to the payroll records, the taxpayer should be informed of the overpayment of tax and instructed to apply for a refund. The exception should be noted in the narrative.

If the taxpayer has under reported tax, an employer withholding deficiency has been identified. A separate employer withholding audit assignment is required. Taxes withheld are trust fund monies, review prior periods for the under-reporting of withholding taxes.

Verify Proper Computation of Tax Withheld

Verify that all taxable compensation was included in the computation of the employer withhold tax and that the tax was withheld at the proper rate for a minimum of one reporting period.

The W-3 is considered the return for reporting purposes of withholding of PA personal income tax. Therefore, a reporting period is one quarter. The auditor may examine one quarter or any period of time greater than one quarter to fulfill this requirement.

The auditor is required to verify that all taxable compensation was included in the computation of the tax withheld. If additional taxable compensation was not included on the individual W-2's submitted to the employees, a separate employer withholding audit must be conducted.

If the compensation used to compute taxes withheld was incorrect, but the proper amount of Pennsylvania compensation was included in Block 16 (beginning 2001) of the W-2s submitted to employees, the following should occur:

- **First Time Audit** – The taxpayer should be informed of the error and the requirement to withhold tax at the statutory rate on all taxable compensation. The taxpayer should be informed that upon subsequent audit, the taxpayer will be held liable for additional tax not properly withheld on Pennsylvania compensation. The auditor should note in the narrative that the taxpayer was informed of the error. The auditor should request through an *Additional Headquarters Processing Request* form that a letter be sent to inform the taxpayer to begin withholding and reporting tax on the taxable Pennsylvania compensation.
- **Subsequent Audit** – The auditor should verify that the taxpayer was previously informed of the withholding requirement. If the taxpayer did not properly withhold tax, a separate employer withholding audit must be requested to assess the additional tax due.

The auditor is required to verify that the proper tax rate was used to compute tax withheld. The verified Pennsylvania taxable wages should be multiplied by the proper rate and the result should be compared to the tax withheld.

If the tax rate was found to be in error, but the proper Pennsylvania taxable wages were included on the employee's individual W-2 for the year:

- **First Time Audit** – The taxpayer should be informed of the error and the requirement to withhold tax at the correct statutory rate. The taxpayer should be informed that upon subsequent audit, the taxpayer will be held liable for additional tax not properly withheld on Pennsylvania compensation. The auditor should note in the narrative that the taxpayer was informed of the error. The auditor should request through an *Additional Headquarters Processing Request* form that a letter be sent to inform the taxpayer to

begin withholding and reporting tax on the additional taxable Pennsylvania compensation.

- **Subsequent Audit** – The auditor should verify that the taxpayer was previously informed of the statutory requirement to withhold tax at the proper rate. If the taxpayer did not properly withhold tax, a separate employer withholding audit must be requested to assess the additional tax due.

The period(s) examined, and the procedures employed to verify the proper withholding of tax at the correct rate for all taxable Pennsylvania compensation must be referenced in the “Areas of Discussion” section of audit narrative.

Obtaining Reported EW Amounts

EW returns are filed on a quarterly basis. Reported amounts for each complete quarter within the statute of limitations should be obtained and compared to the taxpayer’s book amounts.

Reported EW information is maintained within PATH under the Accounts tab in the Customer Springboard. Reported amounts can be downloaded using the instructions for [EW Download](#).

EW Audit Assignments

The overall audit procedures and documentation requirements regarding the conduct of an EW audit are the same as those required for a sales and use tax audit assignment. Exceptions and procedures specific to EW audit assignment are explained below.

EW audits will be designated an assignment number beginning with a WTH prefix. EW audit assignments should be conducted concurrently with the sales and use tax audit assignment.

The information necessary for an assessment of EW should be captured in the Bureau’s audit application software using the schedule templates specific to EW assignments.

Audited vs. Reported Amounts

The audit trail for EW should be documented in the audit report. The auditor should verify that all accrued EW taxes were properly reported on the W-3s for each reporting period in the audit period. The auditor should prepare **an EW Accrual Differences** schedule. This schedule can be found in the “Schedule Template Files (WTH)” within the Bureau’s audit application software. This schedule shall compare the audited and reported amounts.

EW taxes withheld from a sampling of employees should be traced to the original books of entry to verify the taxes withheld were properly recorded in the EW accrual account.

Additional Taxable Wages

If the taxpayer did not include all taxable compensation in the computation of the employer withholding tax and the additional taxable compensation was not included in the employee’s W-2, the auditor should examine all source documents within the audit period to identify all periods where this error occurred.

The auditor should calculate the proper taxable compensation on one of two EW template schedules in the Bureau's audit application software.

Additional Taxable Wages by Employee

The "Additional Taxable Wages by Employee" template schedule is available to calculate additional taxable wages by employee and pay period. The information that the auditor needs to complete this schedule includes pay date, employee name and social security number, gross compensation paid, allowable deductions from gross compensation, and reported taxable wages. The schedule will calculate the audited and additional taxable wages. Supporting schedules should be created if necessary to document the deductions allowed by audit.

Additional Taxable Wages by Quarter

The *Additional Taxable Wages by Quarter* template schedule is available to calculate additional taxable wages by quarter. The information that the auditor needs to complete this schedule includes gross compensation paid, allowable deductions from gross wages, and reported taxable wages. The schedule will calculate the audited PA taxable wages (gross wages less allowable deductions) and additional taxable wages (audited PA taxable wages less reported PA taxable wages). Supporting schedules should be created if necessary to document the deductions allowed by audit.

Incorrect Withholding Rate

If the taxpayer did not use the correct withholding rate in the computation of the employer withholding tax and the additional taxable compensation was not included in the employee's W-2, the auditor should examine all source documents within the audit period to identify all periods where this error occurred.

The auditor should list all the periods that the error occurred on the *Incorrect Withholding Rate* template schedule in the Bureau's audit application software to calculate the additional tax due.

The information needed to complete this schedule includes taxable wages and any additional withholding that is withheld at an employee's request. The schedule will calculate the audited withholding (taxable wages times the rate), audited tax accrual (audited withholding plus additional withholding), and tax accrual difference (audited tax accrual less reported tax accrual).

Pennsylvania Personal Income Tax

General

A limited examination of Pennsylvania personal income tax is required when conducting a sales, use and hotel occupancy audit of a sole proprietorship, partnership, S corporation or Limited Liability Company electing pass through status.

Note: Unless the auditor is working with a sole proprietor, member of a single-member LLC, or 100% shareholder of a PA S corporation, information regarding personal income tax returns for

partners or shareholders such as request for the returns or failure to file returns must not be discussed with the taxpayer's representative or noted in the narrative.

Statute of Limitations

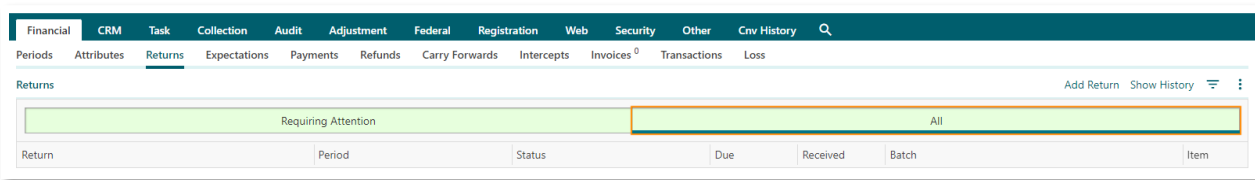
The statute of limitations for Pennsylvania Personal Income Tax (PIT) is three years from the date the return is filed or the return due date, whichever is later. A filing of an extension extends the statute of limitations to three years from the due date of the extension.

If income on the return is underreported by twenty-five percent or more, the statute of limitations is six years from the due date or date the return is filed, whichever is later. If a return has not been filed, there is no limitation imposed by statute.

The PIT examination should be conducted as soon as practical during the sales and use tax audit due to the rolling statute. In situations where the auditor anticipates that the sales and use tax audit will take several months to complete, the auditor should attempt to complete the PIT portion of the audit within sixty **days** of the pre-audit conference to avoid losing a year due to the statute of limitations.

Accessing Personal Income Tax Returns

Personal Income tax returns (including partnership returns) filed with the Department can be accessed through PATH. The auditor must access the individual's Account Springboard, Financial tab, and Returns subtab to review the taxpayer's filing history.



Minimum Requirements

When an audit is conducted on a sole proprietor, partnership, LLC electing pass through status, or an S corporation, the following must be conducted with all sales and use tax audits:

- For S Corporations or Partnerships, verify the entity filed a PA20S/PA65 including the corresponding RK-1 for resident partners, members, or shareholders and/or NRK-1 for non-resident partners, members, or shareholders.
 - Examine PA Schedule NW to verify the proper withholding of tax for non-resident partners, members or shareholders.
- Verify a PA-40, "Personal Income Tax Return" has been filed for partners, members, shareholders, or sole proprietors. Do not verify limited partners.
 - For **S corporations and partnerships**, verify the business income as reported on the RK-1 or NRK-1 was properly reported on the PA-40.
 - For **sole proprietorships**, verify a Schedule C was included in the PA-40.

- **Note:** If the entity has two or more nonresidents, the nonresidents may elect to file a nonresident Consolidated Income Tax Return ([PA-40 NRC](#)) in lieu of filing an individual PA-40.
- A general review of the sales and expenses as reflected on the Schedule C or PA-20S/PA-65 should be made to determine that the reported sales and expenses are materially consistent with the books and records reviewed during the sales and use tax audit. For entities filing a PA20S/PA-65, this will require an examination of Federal Form 1120S/1065 attached to the pass-through return. During this review, the following areas should be examined:
 - Verify the audited gross sales as per the sales tax audit materially reconciles to the gross sales as reported on Schedule C or Federal FF1120S/1065.
 - Verify the expense examination of the sales and use tax audit does not include any personal related expenses of the partners/members/shareholders such as mortgage payments, tuition payments, groceries, or any other expenses unrelated to the operation of the business. If so, verify these expenses were posted to the partner/member/shareholder's equity or distribution account.

If any of these minimum requirements identify non-filed PA-40 returns, improper reporting of RK-1/NRK-1 on the PA-40 or any discrepancies in the reporting of gross sales and/or expenses on the Schedule C or PA20S/PA65 resulting in a material personal income tax deficiency, the auditor should request a review by the Bureau of Desk Review and Analysis (BDRA) by completing the "[BDRA - PIT Referral](#)" template available in Bureau's audit application software. The referral will be attached to a work item created in PATH; refer to [PIT Referral](#) procedures.

NOTE: Beginning January 1, 2006, all federal S-Corporations are considered to be PA S-Corporations other than those who opted out under form REV-976, Election Not to be Taxed as a Pennsylvania "S" Corporation.

Link: [Election Not To Be Taxed as a Pennsylvania S Corporation \(REV-976\)](#)

Required Audit Documentation

The documentation of the procedures performed regarding the limited examination of PIT returns should be limited to the statement in the "Areas of Discussion" section of the audit narrative.

"The entity's state return (PA-20S or PA-65) as filed has been reviewed. The entity has prepared RK-1s for each principal. The total of the pass-through income by category as

shown on the RK-1s equals the total income by category on the entity returns in each year of the audit period”.

No mention should be made regarding the PA-40 comparison to the business records. Also, the audit report should not contain any schedules, attachments or exhibits relating to the Pennsylvania personal income tax return of any member/shareholder/partner.

Limited Liability Company-Filing Guidelines

The tax treatment of limited liability companies (LLCs) are discussed below:

- An LLC that elects to file as an S Corporation with the Internal Revenue Service (IRS) may elect PA Subchapter S status and file using the PA-20S/PA-65.
- An LLC that elects to file as a partnership with the IRS files as a partnership for PA using the PA-20S/PA-65.
- An LLC that elects to file as a single-member disregarded entity with the IRS files as a sole proprietor using the PA-40 if the single member is an individual as defined by PA PIT law. The business activities will be reported on a PA Schedule C, Profit or Loss from Business or Profession (Sole Proprietorship).
- An LLC that elects to file as a “C” corporation with the IRS files as a “C” corporation for PA. The LLC files an RCT-101 and is not considered a pass-through entity for purposes of this examination.

CHAPTER 5-EXAMINATION METHODS

This chapter of the manual specifically describes the general procedures to be followed by an auditor in determining the type of audit method and related procedures in the conduct of an audit.

Determination of the Examination Method

Prior to determining the examination method to be employed, the auditor should discuss the availability of computerized records available for audit with the taxpayer. Computer assisted audits can be conducted using any audit method.

When the taxpayer does not have complete records or when the review of each transaction would be unduly burdensome for the Department to conduct a complete audit in a timely and efficient manner, the Department will determine whether to examine all the records of the taxpayer for the entire audit period, employ a test audit method, or utilize a combination of audit methods.

There are four basic examination methods available:

Complete Audit

All records in the population for the entire audit period are examined.

Modified Complete Audit

All records in the population for a defined timeframe of the audit period are examined. Transactions found to be in error (by customer, vendor, of account) are examined for the remainder of the audit period.

Test Audit

A representative sample(s) from the population is selected from the audit period and examined. The results are used to project the assessment (net deficiency or credit) to the unexamined periods. The primary test audit procedures include stratified random sampling and block sampling.

In addition, alternative testing procedures may be used to estimate tax liability when the taxpayer fails to maintain adequate records to properly conduct a previously listed audit method. These alternative testing procedures include:

- Gross Sales Assessment
- Development of Taxable Sales/Purchases-Elimination of Obviously Nontaxable Items
- Current Sales Sample Audit-Projectable Average (Tally)
- Estimate Taxable Sales using Purchase Records
- Effective Rate/Taxable to Gross Auditing Technique

Combination Audit

Prior to selecting the test period(s), the total population is separated into two or more distinct populations. Each distinct population is examined independently. A test is performed on one (or more) distinct population and a complete or modified complete examination is performed on the non-tested populations(s).

Factors in Determining Method

In making the determination of the method to be used, the Department will consider the following factors:

- The type of tax under audit.
- The nature of the business activities.
- The number of transactions in the population. The narrative must indicate:
 - The number of transactions
 - Source of the transactions such as:
 - General Ledger
 - Sales Journal
 - Purchase Journal, etc.
 - The type of transactions such as:
 - Sales invoices
 - Purchase invoices
 - Journal entry, etc.
- The adequacy and availability of the taxpayer's records. If required records are not made available, the taxpayer should acknowledge that the required records could not be provided on a *Request for Financial Records* form.
- Whether the business is cyclical or seasonal.
- Whether significant changes occurred in the taxpayer's business activities during the audit period:
 - Such as discontinuing a line of business.
- Other relevant factors such as a change in accounting systems, a division going from an individual accounting system to a company-wide centralized accounting system, major changes in the personnel responsible for making the determination of the taxability of items, significant changes in the statutes or regulations governing the taxpayer's business activities and any inconsistencies in the reporting of tax.
 - For example:
 - The taxpayer reports use tax for only 10 months of a 36-month audit period.

These items must be considered and fully addressed whenever a test audit procedure is used. These items must be addressed in the narrative and explanatory documentation should be used when pertinent.

Complete Audit

A complete audit is an examination of all transactions within the population for the audit period. This is the most thorough audit method. However, time, personnel, and resource limitations on the part of the taxpayer and/or the Bureau may make it impractical or unduly burdensome to conduct complete audits.

When computerized records are available, Computerized Audit Support (CAS) may be utilized to perform various sorts, summaries, or merging of taxpayer information to aid the auditor in conducting a complete audit to reduce time and resources on the part of both the taxpayer and the Bureau.

Complete audits of a taxpayer's records are only performed where adequate records are available and where such audits are practical. Complete audits are employed when the volume of transactions are small and the unit price of each transaction is large (*such as mobile homes, boats, airplanes, fine jewelry sales, and construction equipment*).

In the conduct of a complete audit of sales transactions, each transaction occurring during the audit period is examined to determine whether the proper amount of tax has been charged, collected, and reported on all taxable transactions.

In the conduct of a complete audit of capital and expense transactions, each transaction occurring during the audit period is examined to determine if the vendor charged sales tax or the taxpayer accrued and reported use tax on all taxable transactions.

All additional taxable transactions are individually listed on the appropriate Bureau's audit application software template schedules and summarized by reporting period for assessment.

Modified Complete Audit

This method of auditing may be used when the taxpayer's record keeping systems, accounting structure, sales customers/expense vendors are generally consistent throughout the audit period. This method is generally not used when the taxpayer has had a significant change in the type of products sold (or purchased), the customers (or vendors) change frequently from year to year, and the taxpayer's records are capable of being audited on a complete basis with minimal additional field time.

A complete audit is conducted on a defined timeframe of the audit period (such as one year or a reporting period in each year). Like transactions, customers, vendors, or accounts found to be in error are examined on a complete basis for the remainder of the audit period.

When computerized records are available, Computerized Audit Support (CAS) should be used to sort data to identify transactions pertinent to the various accounts, customers, cost centers, or other criteria that is used by the auditor to identify transactions to be examined when employing a modified complete examination.

Note: The original periods, time frames or areas reviewed to determine the scope of the modified complete examination of the remainder of the audit period must be specifically identified in the audit narrative.

Test Audit

The Department is authorized by statute to use test procedures in an audit (**72 P.S. §10003.21**). Title **61 PA Code § 8a** also governs the use of test audit procedures. Test audit procedures are used when complete records are not available or when it would be impractical to perform an examination of the taxpayer's records on a complete basis.

Only a sample of the transactions from the entire population for the audit period is examined in detail for the purpose of verifying the taxpayer's compliance.

Because the audit findings are supported only by a sample of the total transactions occurring during the audit period, the audit narrative and supporting documentation should make it very clear that:

- Reviewing each transaction would be unduly burdensome and
- To review each transaction could not be accomplished in a timely and efficient manner.

Since each additional taxable transaction identified within the test period(s) is extrapolated across the entire audit period, it is very imperative that the auditor clearly explain the basis for assessment for each additional taxable transaction within the test period(s). This should be accomplished through pertinent citations, supporting documentation (*such as copies of invoices or purchase orders*), clear descriptions in the audit narrative and on the audit schedules, and the inclusion of account and/or cost center to which the transaction was posted. When account coding or cost centers are included on the audit schedules or in the audit narrative, a chart of accounts and/or a listing of cost centers should be included as an exhibit in the audit report.

Prior to performing a test audit procedure, the auditor will determine through review of the taxpayer's general ledger accounts, review of past audits, and discussion with the taxpayer, what cost centers, customers, vendors, accounts, or other areas (if any) will be eliminated from the test population and audited on a complete or modified complete basis. This must be performed prior to the selection of the test period(s).

Link(s): [61 Pa. Code Chapter 8A. Enforcement](#)

Taxpayer's Concurrence with Test Audit Plan

Prior to performing test audit procedures, the auditor is required to provide the taxpayer with a written plan of the test audit pursuant to **61 PA Code § 8a.8**. The test audit plan is documented on the *Taxpayer's Concurrence with Test Audit Plan* form, which is available as a template in Bureau's audit application software. The plan must be in writing and include the following:

The time period subject to audit (Audit Period)

The audit period will be extended under limited circumstances.

The objective of the test and the type of test being performed.

The clear objective of the test must be documented such as *"Verify sales tax was charged, collected, and reported on all taxable sales transactions."* In addition, the type of test

must be documented (i.e., Block Sample- Projectable Average or Stratified Random Sample).

Population to be tested

Define the test population by identifying the type of transactions and the source of the transactions. For example, “*All sales transactions posted to selected accounts as per the sales journal for the entire audit period.*” The selected accounts must be listed on the test form or referred through a schedule or exhibit.

The period(s) selected for examination (test periods(s))

The actual periods that are going to be examined and the periods that they will represent should be listed on the form (i.e., July 2022 for CY 2022).

Basis for selecting test period

The methods for selecting the test periods must be explained including a schedule detailing how the test periods are selected. If a proper basis was not used for selecting the test periods due to a lack of records, a *Request for Financial Records* form must be included in the audit report to substantiate that the auditor made a reasonable attempt to obtain the records necessary to properly select the test period(s). The schedule or request must be referenced on the test audit plan and referenced in the narrative.

The procedures that will be used during the test

A description of the procedures that will be used and how the results will be projected should be included in this section of the form. The plan must state:

- The way any tax liability will be calculated based on the records reviewed,
- An error rate will be developed by dividing the total additional taxable transactions by the total amount of the transactions in the test period.
- The error rate will then be multiplied by the total amount of the transactions in the unexamined periods to arrive at the total projected taxable amount.
- The total projected taxable amount will be multiplied by the applicable tax rate to compute the total projected deficiency for the population tested for the audit period.

When a stratified random sample is used, the Computerized Audit Support (CAS) division or regional computer assisted audit representative will prepare the “Taxpayer’s Concurrence with Test Audit Plan” form.

The plan must be presented to the taxpayer. The taxpayer should be asked to sign, date, and include their title on the form. The taxpayer should also be asked to indicate on the form if the business activities were cyclical or seasonal, or if there were significant changes in the taxpayer’s business activities during the audit period significant enough to affect the selection of test periods and application of test audit procedures.

The taxpayer should be asked to indicate on the form any reason they may have for disagreeing with the selection of the test sample and/or test audit procedures to be employed.

The auditor must evaluate the taxpayer's concerns and address them in the audit narrative. If the taxpayer's concerns are reasonable and can be substantiated, the auditor may adjust the test population to address the taxpayer's concerns. If the adjustment results in any deviation from the originally selected test period(s), a letter or email requesting the change, which states the reason for the request must be obtained from the taxpayer and included in the audit report. At this point, a second *Taxpayer's Concurrence with Test Audit Plan* form should be completed and presented to the taxpayer.

If the taxpayer declines to sign the *Taxpayer's Concurrence with Test Audit Plan*, the auditor should indicate on the form:

- Whom the form was presented to.
- The date the form was presented.
- Note: "Taxpayer Declined to sign the form".

The fact that the taxpayer declined to sign the form does not preclude the auditor from conducting the test audit.

NOTES:

- When the auditor expects to conduct a test audit of the hotel occupancy tax and sales tax as part of a hotel audit, the population for choosing test periods for the examination of the hotel occupancy tax must be different from the population used to examine sales tax. This is necessary because sales tax and hotel occupancy tax operate under different exemption rules. Separate error rates and projections should be calculated for each area of tax.
- Separate test forms are required for each test conducted, i.e., Sales tax and hotel occupancy.

Inclusion of Credits in the Test Period Audit Findings

When a test period for expenses is selected on a representative basis using key characteristics, credits for use tax paid directly to the Commonwealth on nontaxable transactions will be included in the numerator of the error rate. The overpayment should not be netted against the underpayment in the calculation of the error rate. Separate error rates will be calculated for overpayments and underpayments.

Refer to [Chapter 4](#), "*Use Tax Credits Recognized by Auditors, Use Tax Overpayments*" when projecting credits.

When the test period(s) chosen is less than one reporting period per year, the approval of the Regional Manager in writing is required before a credit projection can be made.

Only credits for taxes paid directly to the Commonwealth (use tax) may be projected through a block sample test audit. Third party credits may not be granted on a test basis, except for when a stratified random sample method is used, and the population used to select the sample covers the entire audit period. Any projection of third-party credits where the population is less than the entire audit period requires approval of the Sales and Use Tax Program Administrator.

Credits should not be projected when the test periods were selected based on a scope limitation such as the availability of records or use tax reported on expenses was not consistent. This requirement may be waived if the records for a substantial portion of the audit period are available, and the sample(s) selected are chosen as representative from those periods that are available.

Credit Schedule Requirements

Credits are normally recorded on the same schedule as underpayments, but these transactions must be coded as either a “3” or “U” tax category. For test audits, transactions coded with these tax categories will result in separate third-party credit and use tax credit error rate calculations and projection schedules in the Sales and Use Tax Report.

Refer to [Chapter 4-“Use Tax Credits Recognized by Auditors”](#) section of this manual for further detail on credits.

Taxes Paid – Purchases Resold

Credit for Taxes Paid on Purchases Resold (TPPR) may **not** be included in the audit findings as a projection, except for Stratified Random Sample. TPPR credits are similar to third party credits; therefore, a test audit of TPPR credits is only permissible through the use of Stratified Random Sample if the population used to select the sample covers the entire audit period. Any projection of TPPR credits where the population is less than the entire audit period requires approval of the Sales and Use Tax Program Administrator.

Note: TPPR credits associated with inventory related accounts should be addressed through a separate population.

Test Methods

Stratified Random Sample

Stratified Random Sample test procedures will only be conducted in conjunction with computer assisted audit (CAA) personnel and will utilize computerized records.

Ideally, Stratified Random Sample tests utilize transactions from the entire audit period. However, Stratified Random Sample testing may be performed in conjunction with a projectable average computation when the population of transactions selected for the Stratified Random Sample does not encompass the entire audit period.

Record Requirements

Computerized records and related source documents should be requested for the entire audit period on a *Request for Financial Records* form. In addition, the auditor should have the taxpayer acknowledge that the source documents are available for the entire audit period. If the taxpayer cannot or will not make the records available for the audit period, the auditor should have the taxpayer indicate this fact on the *Request for Financial Records* form, by acknowledgement of email, or a letter signed by the taxpayer. In no case should less than one

complete accounting cycle (usually one year) be used to select the Stratified Random Sample without approval from the Sales and Use Tax Program Administrator.

Selection of Stratified Random Sample Size

When utilizing a stratified random sample method, the initial sample size will be determined by past Bureau experience. To achieve the desired precision, the size of the sample will be based on the stratified data. The sample size may be increased until mutual agreement is reached between the Department and the taxpayer or until the desired precision is obtained.

Stratified Random Sample Procedures

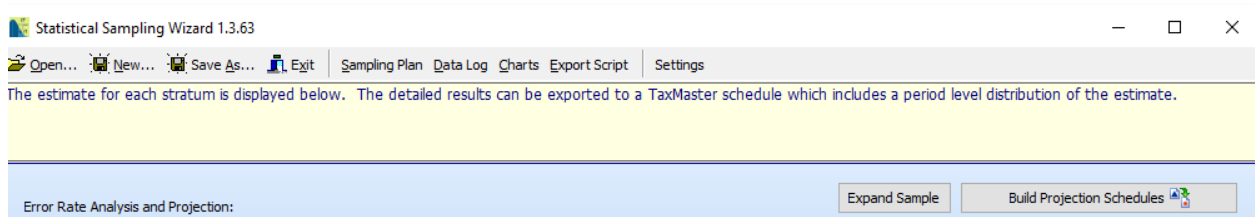
Computerized transactions are obtained from the taxpayer and presented to CAA personnel. CAA can accept files in most widely used file formats. CAA will sort and subtotal the records at the auditor's direction and present the auditor with the results. The auditor must verify the taxpayer's computer data is complete prior to CAA pulling a sample. Some acceptable methods of verification include:

- If the data was obtained from the accounts payable system and both debit and credit records were provided, use the change in the balance of the accounts payable liability account for the same period of time. If the data was obtained from the accounts payable system and only debit records were provided, compare the value of the credit records in the accounts payable account for the same period.
- If general ledger detail was obtained for audit purposes, compare several of the most material expense account totals to income statements or trial balance sheets for the same period.
- Compare several expense account totals to general ledger balances for the same period. If accounts payable data was obtained for audit purposes, reconciliation will need to be performed to identify differences due to entries from other journals (Payroll, General Journal, Accounts Receivable, etc.).

Test Population

Methods of verification may vary depending on the taxpayer's accounting system. Once the test population has been verified as complete, the auditor will identify for CAS any obvious nontaxable accounts such as insurance, taxes etc... that should be excluded from the test population. Only those accounts with potential tax liability should be included in the test population. The auditor should also identify any accounts to be excluded from the test population and examined on a complete basis.

CAA will eliminate those areas of the population identified by the auditor, perform the stratification, and identify the items or transactions to be included in the test sample. CAA will prepare the *Taxpayer's Concurrence with Test Audit Plan* form. CAA and/or the auditor will present and explain this form to the taxpayer.



The auditor will present the test sample to the taxpayer along with a *Request for Financial Records* form requesting that the taxpayer pull the records for examination. It is the auditor's responsibility to review all transactions in the statistical sample. The auditor may not replace transactions from the sample even if the records are missing.

Projection Schedules

CAA or the auditor will compute the error rate, perform the projection, and calculate the precision utilizing the statistical sampling wizard (SSW) within Bureau's audit application software. The SSW will calculate the error rate as well as generate a projection schedule and precision schedule.

Precisions

The auditor will notify the taxpayer of the results of the projection and discuss the precision of the projected deficiency. The auditor must complete and present the *Taxpayer's Acknowledgement of Precision Level - Stratified Random Sample* form to the taxpayer, which is available as a template in Bureau's audit application software.

Taxpayer's Acknowledgement of Precision Level -Stratified Random Sample Form

This form must be completed and presented to the taxpayer as soon as possible to allow the taxpayer time to review the sample errors and results. The completed form must be included in the audit report.

Taxpayer Accepts Precision Level:

- If the taxpayer signs the form and indicates, "I accept the precision as indicated and do not request an increase in sample size, no further testing is required.
- The projection resulting from the stratified random sample is included in the audit report.

Taxpayer Does Not Accept Precision Level

- If the taxpayer signs the form and indicates "*I do not accept the precision as indicated and request an increase in the sample size*", the auditor should complete the following:
 - Request that the taxpayer provide the precision level they will accept. At the minimum, an acceptable precision level is 25%.

- Inform CAA of the requested precision level. CAA will identify the additional number of transactions needed to achieve the desired precision level and provide these additional transactions to the auditor.
- Provide taxpayer with a *Request for Financial Records* form along with the list of additional transactions.
- Provide the taxpayer with a revised “*Taxpayer’s Concurrences with Test Audit Plan*” reflecting the new sample population. CAS will create the new test form.
- Allow 30 days for taxpayer to present the additional records.
- Review the additional transactions.
- CAA or Auditor will compute the error rate, perform the projection, and calculate the precision utilizing the statistical sampling wizard (SSW), within the Bureau’s audit application software.
- Present an updated *Taxpayer’s Acknowledgement of Precision Level-Stratified Random Sample* form for the taxpayer to review.
- If the taxpayer does not provide the additional requested records, the original sample will be assessed.

Taxpayer declines to complete the form

- If the taxpayer or their representative declines to complete *the Taxpayer’s Acknowledgement of Precision Level – Stratified Random Sample* form, the auditor should indicate the name of the representative that was presented the form, the date the form was presented, and note the representative declined to sign on the form, which will be included in the audit report.
- If precision of the sample is greater than 25% the auditor should follow the above steps under “Taxpayer Does Not Accept Precision Level”.
- If precision of the sample is 25% or less, no additional procedures are necessary, and the original sample will be assessed.

Application of Credits

Credits will be included in the numerator of the Stratified Random Sample for use tax paid by the taxpayer directly to the Commonwealth. This credit will only be included in the Stratified Random Sample calculation when the auditor can trace the use tax coded on each transaction to the use tax accrual account, and all use tax accrued was remitted. When less than the entire audit period was used to select the sample, the auditor must verify that use tax was reported consistently throughout the audit period prior to projecting credits.

Third-party credits and TPPR credits may be included in the Stratified Random Sample computation provided the population encompassed the entire audit period. Any exceptions must be approved by the Sales and Use Tax Program Administrator.

Sample Period Less Than Audit Period

If the Stratified Random Sample was selected from less than the entire audit period, it is necessary to compute a projectable average (error rate) to be applied to the periods not included in the sample selection. An error rate should be computed by dividing the total projected additional taxable transactions by the total amount of the transactions in the SRS population. The error rate should be multiplied by the total amount of the transactions from the same accounts for the periods excluded from the population to arrive at the total taxable transactions for the unexamined periods.

Separate error rates must be calculated for each tax code and tax category such as use tax overpayments, third party credits etc. Estimated Error Rates are automatically calculated on the SRS Projection schedules(s) for each tax code and tax category with findings.

Direct Payment Permit Holders-Formulary Method of Reporting Use Tax

During the pre-audit conference of direct payment permit holders, the taxpayer shall be informed that a formulary method of reporting use tax on expenses is available and that the procedures for computing a use tax factor for expense transactions can be performed during the current audit. If a taxpayer is interested in formulary reporting of use tax, applications are available through headquarters.

Statistical sampling procedures must be used to develop the factor for formulary reporting of use tax on expenses.

The Formulary Factor:

Included in the Numerator

- All expense transactions with a net change (additional taxable purchases less nontaxable purchases where use tax was erroneously reported).
- All expense transactions in the test sample where the taxpayer properly reported use tax.
- All expense transactions in the test sample where the taxpayer properly paid sales tax to the vendor except those for which it was mutually agreed to exclude, for example:
 - Hotel Occupancy
 - Restaurants
 - Telecommunication Services

Included in the Denominator

- The total dollar value of all transactions in the test sample.

NOTE: Audit Periods for Direct Payment Permit holders should end on a calendar year, December 31.

Block Sample-Projectable Average

When a block sample method is chosen, the Department will select blocks of time in which the average is approximately equal to the computed average of key characteristics for the type of transaction and the time period to which they apply.

Selection of the Population to Be Tested

Prior to selecting test periods, the population to be tested must be defined. The taxpayer's general ledger accounts shall be examined to determine what accounts (if any) should be eliminated from the population being tested and audited independently of the test procedure. Accounts with large dollar amounts and relatively few transactions should be excluded from the tested population prior to the selection of the test period(s) and audited on a complete basis; refer to [Chapter 4-Expense Purchases](#) for further detail.

The error rate computed for a test period shall be applied only to those periods and population from which the test period was selected with two exceptions:

- When the taxpayer does not make records available for the entire audit period.
- The taxpayer provides express written consent (letter or email) to applying the results of test period to periods excluded from the population used in the selection of the test period. (For example, bring an audit current if audit was put on hold for several months before the beginning of the fieldwork.) This consent must be exhibited in the audit report.

Local Tax Consideration

When it has been determined that the taxpayer had sales locations during the audit period in a jurisdiction(s) that imposes a local sales tax, separate error rates must be computed for each jurisdiction.

The auditor should request that the taxpayer provide detailed sales information by location for each reporting period in the audit period on a *“Request for Financial Records”* form. It is the taxpayer's responsibility to provide the sales breakdown by location. The auditor should verify the accuracy of the information provided to the taxpayer's books but should not spend time extracting the information.

If the taxpayer can provide a breakdown of sales by location, separate test periods should be selected for each local tax jurisdiction. The numerator of the error rate will be the total additional taxable sales (by jurisdiction); the denominator will be the total sales of the test period for each local jurisdiction.

When the taxpayer cannot provide a detailed breakdown of sales by location for each year in the reporting period, the test period(s) selected for state sales tax will be used to examine the local sales. The numerator will be the total additional taxable sales subject to local sales tax (by jurisdiction). The denominator will be the total sales of the test period.

When the taxpayer cannot provide detailed sales locations by jurisdiction, the auditor should verify that the locations required to charge and collect local sales tax during the test period(s) had sales in the periods in which the error rate will be projected. If it can be determined these locations did not have any sales during a portion of the audit period, the error rate will be applied to only those reporting periods when these locations had sales.

Selection of Block Sample Size

When utilizing a block sample method, the sample size required is as follows:

- One reporting period in each year of the audit period. Partial years may be combined with complete years (up to an aggregate of 18 consecutive months) for the purposes of choosing a single test period. The error rate established for each test period shall be applied to only those periods from which the test period was selected (or)
- One complete year (calendar or fiscal) within the audit period.

The taxpayer should be presented with a *Request for Financial Records* form that specifically requests the records required to properly select the test periods. All block sample audits should be approached using these criteria.

Deviation from the Test Period Requirements

Deviation at Taxpayer's Request

If the taxpayer requests that fewer test periods be examined, the auditor must obtain a written acknowledgement from the taxpayer attesting to their request. The acknowledgement must be:

- Written by the taxpayer on the taxpayer's letterhead.
- State specifically the number of reporting periods requested to be examined.
- State the specific reason for the request of deviation.
- Include the date of the request.
- Include a statement that the individual signing the request is a duly authorized representative.
- Include a signature of the authorized representative.

The auditor may also accept this information in an email from the taxpayer or as a response on the *Taxpayer's Concurrence with Test Audit Plan* form signed by the taxpayer.

This acknowledgment should be included in the audit report as an exhibit and referenced in the audit narrative and on the *Taxpayer's Concurrence with Test Audit Plan* form. The auditor must document that the taxpayer's business activities were relatively consistent throughout the periods for which the test period(s) apply and that there is no reason to believe the test period(s) chosen are not representative of the entire period to which the results will be applied. The supervisor must acknowledge the deviation of the test periods by indicating his/her agreement on the *Conflict of Interest Statement and Auditors Comments* form.

In all cases where the taxpayer requests that less than the required number of periods be examined, the auditor shall make a documented effort to obtain computerized records and pursue a statistical or other form of computerized audit procedure.

Deviation at the Bureau's Request

The Bureau may not unilaterally deviate from the required number of test periods without written approval from the Program Administrator. This decision will be based on the total number of transactions per reporting period, the availability of records, and the results of the findings of prior audits of the taxpayer. It is the auditor's responsibility to indicate it would be unduly burdensome to examine additional records.

When less than the required number of test periods are selected and computer records are not available, the test period (s) will be selected from the periods for which the error rate will be applied. For example, if the taxpayer presents a written request that one reporting period be selected to represent the entire audit period, the period selected will be the reporting period closest to the average key characteristics computed for the entire audit period. The supervisor must comment on the *Conflict of Interest Statement and Auditors Comments* form that they reviewed and agreed with the size of the sample and method used to conduct the test selection.

Documentation of the Test Periods

The taxpayer should be presented with a *Request for Financial Records* form that specifically requests the transactional detail for the selected test period(s), as well as a *Taxpayer's Concurrence with Test Audit Plan* form. All block sample audits should be approached using these criteria.

The selection of the test periods must be supported by a schedule. A schedule must be included in the audit report that shows the calculation of the selection of the test periods. The schedule must clearly indicate the test period(s) chosen, include a footnote referencing the accounts or other items eliminated from the population prior to selecting the test periods, and contain a footnote referencing partial or combination years used to select a test period. The schedule must be included in the audit report. The schedule must be referenced in the narrative and on the *Taxpayer's Concurrence with Test Audit Plan* form. The only exception to this should be when records are not adequate to determine test periods based on average key characteristics.

Records Not Available to Properly Select Test Periods

In every instance where adequate records are not available to select test periods based on average sales, expenses, or some other key characteristic, a *Request for Financial Records* form must be included in the audit report to support that the necessary records were requested,

and the taxpayer was given a reasonable amount of time to produce the records. The *Request for Financial Records* form should be referenced on the *Taxpayer's Concurrence with Test Audit Plan* form under the "Basis for Selecting Test Period", included in the audit report, and referenced in the audit narrative. When records are not available for the entire audit period, the test periods will be selected based on the characteristics of the periods for which records are available.

Factors That Must Be Considered When Determining Test Periods

The following factors must be considered and discussed in the narrative when determining test periods:

- Average Gross Sales or Average expenses (use actual if reported amounts are incorrect).
- Ratio of taxable to gross sales (when applicable)
- Whether the taxpayer's business is cyclical or seasonal.
- Significant changes in the business activities during the audit period.
- Significant changes in the law, regulation, or policy during the audit period.
- Adequacy and availability of taxpayer's records.
- Other relevant factors that could affect the representation of the selected test periods.

Computation of the Projectable Average (Error Rate)

One error rate will be computed for each test period and be applied only to the population from which the test period was selected.

Error rates will be computed to six decimal places and rounded to five decimal places.

Numerator

All additional taxable transactions will be recorded and included in the numerator of the error rate calculation. Credit for use tax paid directly to the Commonwealth will be included in the numerator when the auditor can verify use tax was erroneously accrued and reported on a nontaxable transaction. The auditor should also verify that credit had not previously been granted through a refund petition. Separate error rates will be calculated for additional taxable transactions and nontaxable transactions where use tax was erroneously reported.

Credits will not be included in the projectable average computation if the test period was selected based on a lack of records. The auditor may not project any TPPR or third-party credits using a block sample.

Denominator

The denominator will be the net dollar value of all transactions in the test period.

When it appears that the characteristics of the business for particular periods have changed and conditions are not constant or comparable, or where changes in the law substantially affected the taxability of merchandise or services sold by the vendor throughout the audit

period, a separate error rate should be computed for periods before and after the material changes.

The dollar amount of the denominator should be the same as the dollar amount listed for the same period(s) on the schedule used to select the test periods. One error rate for each tax code and tax category will be computed for each test period and be applied only to the population from which the test period was selected.

Isolating Transactions in the Test Sample

When conducting a block sample, every transaction determined to be an outlier will be removed from the numerator prior to the computation of the error rate and treated as an isolated transaction. The outlier will be identified in the audit narrative and assessed on a separate audit schedule. The outlier will remain in the denominator of the projectable average calculation. The remainder of the audit period will not be examined to determine if like transactions occurred in other reporting periods.

Outliers

Title **61 Pa. Code §8a, “Enforcement,”** gives guidance in determining (quantifiably) which transactions found to be deficient in the test period should be isolated from the test period’s results prior to computing the error rate.

If an item is greater than 2% of the total tested population, that transaction is a “suspected” outlier. Any transactions identified as a “suspected” outlier will be considered a “confirmed” outlier. Both additional taxable transactions and use tax credit transactions may be outliers.

The Bureau’s audit application software is programmed to identify an outlier if a transaction is greater than 2% of the population being tested. Therefore, any transaction listed on a schedule for projection that is greater than 2% of the test population will be excluded from the numerator of the error rate and assessed on a separate schedule as an isolated transaction. The transactions determined to be outliers will remain in the denominator of the error rate computation.

Test Periods not Selected Using an Average

When test periods are not selected based on average key characteristics due to the unavailability of records, the requirement to isolate transactions greater than 2% does not apply. The reason being that the scope limitation imposed from the lack of records does not allow for an adequate and complete review of large dollar transactions. In this circumstance, the auditor may:

- **Leave the transaction in the numerator.**
This may be performed when the selected test period is not considered to be a representative period because it was selected based on lack of records or;
- **Isolate the transaction and treat it as an outlier.**
This may be performed when the selected period is considered a representative period or;
- **Examine like transactions on a complete basis and project on the remaining deficient transactions.**

Under the third bullet, the denominator will be reduced by the total of any transactions reviewed in this manner. This is allowable because changing the denominator will not affect the selection of the test period since the selection was not based on any average characteristics.

Discontinuing the Test Audit Procedure

When conducting a block sample test on one reporting period in each year of the audit period and no exceptions were found in the first test period examined, the auditor may abandon the examination of the remainder of the test periods if:

1. the business activities were consistent in each year of the audit period and
2. the taxpayer's reporting history was relatively consistent.

When performing a block sample test on one reporting period in each year of the audit period and very few transactions are found to be deficient during the first period examined, the auditor may perform a limited examination on the remaining test periods. Like items, as those found to be deficient, should be examined on a modified complete basis for the remainder of the audit period and no projection shall be made for assessment purposes. This may only be performed when very few customers (vendors) are found to be deficient, the items sold (purchased) during the audit period remained constant, the taxpayer's reporting history is relatively consistent, and the majority of the sales are to repeat customers (or purchases are continuously made from the same vendors).

Examples of Test Period Selection

All Sales in Audit Period Included

When identifying the periods to sample when the population to test includes all sales for the audit period, the auditor should:

- Identify the three periods in each year (or partial/combination year) that are closest to the average sales for the year.
- Of the three periods coming closest to the average in each year, choose the period that comes closest to the average taxable sales to gross sales ratio for the year.

All Sales in Audit Period not Included-Combination Audit

When identifying the periods to sample when the population to test includes only a subset of all sales for the audit period, the auditor should select the test periods using only the key characteristics of the subset of the population that to be tested that are available. The sales and/or taxable to gross used to compute averages should include only those sales being tested.

Separate block sample tests may be performed on various populations. When this is performed, a separate test period must be chosen in each year for each population tested.

When segregating sales into separate test populations, the supporting schedule must clearly define the populations tested.

Gross Sales Assessment

Note: The following methods should only be used when the taxpayer does not maintain or provide auditable source documents such as sales invoices for the audit period.

Prior to utilizing this audit method, the auditor must present the taxpayer with a “*Request for Financial Records*” form, requesting the records necessary to conduct the audit utilizing a complete audit method, a modified complete audit method, or a test audit method using representative test period(s).

When it is impossible or impractical to effectively employ another type of audit method because of a taxpayer’s failure to maintain or provide auditable source records such as sales invoices or receipts, the Department may assess the taxpayer on the gross amount of the verified sales. The results of the gross sales assessment computation should be presented to the taxpayer. The taxpayer should also be given an additional *Request for Financial Records* form, requesting that the taxpayer provide sufficient competent evidence that would support the computation of the tax actually due.

The Revenue Regional Manager must approve this procedure before it is used to establish an audit assessment. This memo must be attached to the *Additional Headquarters Processing Request* form.

In the conduct of an audit resulting in a gross sales assessment, every reasonable attempt must be made to eliminate obvious nontaxable transactions from gross sales. If any of the taxpayer’s records permit the development of a sample technique that will reliably measure the extent of nontaxable transactions, such a technique should be implemented.

The difference between the verified gross sales and the reported taxable sales should be assessed as the additional taxable sales for the audit period as illustrated below.

Note: This audit method may be adapted for use with expenses, capital purchases, PTA and VRT.

Gross Sales Assessment Example

This example will show the application of an imposed tax rate on verified gross sales.

Period End	Verified Gross Sales	Reported Taxable Sales	Additional Taxable Sales
1/31/X1	87,500	16,667	70,833
2/28/X1	120,000	33,333	86,667
3/31/X1	112,000	43,333	68,667
Total	319,500	93,333	226,167

Figure 5.1 Gross Sales Assessment Example

A schedule like this may be created using the blank template available in the Bureau’s audit application software.

Development of Additional Taxable Sales (Purchases) by Eliminating Obvious Nontaxable Items

Prior to utilizing this audit method, the auditor must present the taxpayer with a “*Request for Financial Records*” form, requesting the records necessary to conduct the audit utilizing a complete audit method, a modified complete audit method or a test audit method using representative test period(s).

This audit method is generally used on sales when the taxpayer has not maintained adequate auditable source documents such as sales invoices but has maintained documentary evidence that a portion of sales were obviously nontaxable. This audit method may be adapted for use on capital purchases or expenses if the taxpayer has not maintained sufficient source documentation such as payable invoices but does maintain capital purchases or expense totals and some documentation indicating the purchase(s) were put to a nontaxable use (such as obvious direct use in public utility, manufacturing, or mining). There must be convincing evidence that the specific sale or purchase is nontaxable prior to eliminating the item from the gross amount.

Before using this test procedure, the supervisor must be consulted. The technique employed is designed to eliminate those clearly nontaxable transactions from a representative test period, thereby creating a presumption that the remaining items within the test period are taxable. The test findings are then projected to the entire audit period. The results of the Development of Taxable Sales (Purchases) assessment computation should be presented to the taxpayer. The taxpayer should be given an additional “*Request for Financial Records*” form requesting sufficient competent evidence that would support the computation of the tax actually due.

In the conduct of this type of audit, the auditor identifies obviously nontaxable transactions in the sample period (e.g., clothing, prescription drugs, direct use etc.). The total nontaxable transactions for the sample period are then subtracted from the total gross sales(purchases) of the sample period. The difference, the taxable transactions are divided by the total gross sales (purchases) of the sample period. This taxable ratio is then applied to the total gross sales (purchases) of the unsampled periods to arrive at the audited taxable sales (purchases).

Eliminating Obvious Nontaxable Sales - Example

This example will show the application of eliminating obvious nontaxable sales from a sample period to develop an error to apply against verified gross sales in other periods.

Sample Period

Sample Period	Sample Gross Sales	Sample Obvious Nontaxable Sales	Sample Taxable Sales	Sample T:G Ratio
1/1/X1 - 1/31/X1	100,000	20,000	80,000	0.8

Figure 5.2 Eliminating Obvious Nontaxable Sample Period

Apply to Other Unsampled Periods

Period End	Verified Gross Sales	Sample T/G Ratio	Audited Taxable Sales	Reported Taxable Sales	Additional Taxable Sales
1/31/X1	87,500	Actual	80,000	16,667	63,333
2/28/X1	120,000	80%	96,000	33,333	62,667
3/31/X1	112,000	80%	89,600	43,333	46,267
Total	319,500		265,600	93,333	172,267

Figure 5.3-Eliminating Obvious Nontaxable Projection

Auditing of Sales Using Prospective Records

Prior to utilizing this audit method, the auditor must present the taxpayer with a *Request for Financial Records* form requesting the records necessary to conduct the audit utilizing a complete audit method, a modified complete audit method, or a test audit method using representative test period(s).

Auditing of sales using prospective records is used when the taxpayer has failed to maintain auditable sales tax records for the audit period. In this audit method, the auditor will perform an examination of prospective sales records for a sample period and use the results as a basis for any sales tax assessment. The basis consists of detailing a sufficient number of prospective sales records to establish an average percentage of taxable sales to gross sales and an average effective rate of tax incurred.

Because a prospective period is being used, it is recommended to extend the audit period to include the prospective period.

The average taxable to gross sales ratio of the prospective period is applied to the audited gross sales of the audit period to arrive at the audited taxable sales. The reported taxable sales should be subtracted from the audited taxable sales to arrive at the additional taxable sales.

Estimating Taxable Sales Using Purchase Records

Before using this procedure, the supervisor must be consulted. When a taxpayer has failed to maintain adequate sales tax records such as sales invoices but has maintained adequate purchase and gross sales records, a sales tax liability may be established from a sampling of purchase records.

Prior to utilizing this audit method, the auditor must present the taxpayer with a *Request for Financial Records* form requesting the records necessary to conduct the audit utilizing a complete audit method, a modified complete audit method, or a test audit method using representative test period(s).

When this method is used, each purchase for resale occurring in the sample period is examined and classified as either a taxable type of purchase (i.e., a purchase which upon resale ordinarily

would be taxable) or a nontaxable type of purchase (i.e., a purchase which upon resale is not taxable).

When summarizing the sample findings, the total of the taxable type purchases for the sample period is divided by the total sample period purchases. The ratio derived may then be applied to gross sales for the entire audit period if there is not a substantial difference in the average markup on taxable and nontaxable merchandise.

If substantial differences can be established by product or product type, the auditor may use a combined markup or individually apply the markup by product.

Average Industry Markup

Average industry markup of cost of goods sold to sales may be used when other adequate documentation is not available. Headquarters has access to various reference materials regarding industry average markup of cost of goods sold. These industry averages may be used to determine the reasonableness of the taxable purchases to gross purchases ratio claimed by the taxpayer when adequate documentation is not maintained to verify the taxability of actual sales transactions on an individual basis. Typical use of these averages would include examinations of smaller retail establishments such as restaurants.

Sample Period

Sample Period	Sample Gross Sales	Taxable Purchases	Sample T:G Ratio
X1	100,000	80,000	0.8

Figure 5.4 Taxable: Gross Ratio from Purchase Example

Projection of Taxable Sales

Period End	Verified Gross Sales	Sample T/G Ratio	Audited Taxable Sales	Reported Taxable Sales	Additional Taxable Sales
1/31/X1	87,500	80%	70,000	16,667	53,333
2/28/X1	120,000	80%	96,000	33,333	62,667
3/31/X1	112,000	80%	89,600	43,333	46,267
Total	319,500		255,600	93,333	162,267

Figure 5.5 Projection Using Estimate from Purchase Example.

Estimating Gross Sales using Form 1099-K

Form 1099-K is an IRS form used to report transactions made via payment settlement entities. These entities process credit and debit card transactions. The 1099-K lists the amount of credit and debit card transactions processed and deposited into the taxpayer's bank account. The 1099-K is an effective tool for estimating gross sales as the sales information is provided by a third party; therefore, it is considered complete and accurate.

The 1099-K only reflects credit and debit card transactions. Therefore, the Department applies a "1099K" ratio to the amounts listed on the 1099-K to estimate gross sales. This procedure accounts for sales where the payment was not a credit card or debit card such as cash sales. The "1099K" ratio is calculated using the taxpayer's prospective records or industry average.

1099K Ratio Using Prospective Records

When the taxpayer does not maintain any auditable sales records as required by 61 Pa. Code § 34.2. Keeping of records or the sales records are incomplete, the auditor should request the taxpayer to maintain auditable sales records for a prospective month. The sales records should consist of transactional records such as sales invoices, guest checks, POS reports, register tapes as well as daily summary reports. The transactional records should detail the items sold, sales tax charged, tender type (cash vs. credit), and tip amounts, if applicable. The daily reports should summarize the taxable and nontaxable sales, tender type, sales tax charged and the applicable tips.

The "1099K" ratio is calculated by dividing the total credit card sales transactions inclusive of the sales tax and tip by the total sales transaction exclusive of sales tax and tip. The amounts listed on the taxpayer's 1099-K form are divided by the calculated "1099K" ratio to arrive at the Audited Sales. If the taxpayer has nontaxable sales, a taxable to gross sales ratio is calculated using the prospective records. This ratio is multiplied by the Audited Sales to arrive at the Audited Taxable Sales. The Audited Taxable Sales are multiplied by the effective sales tax rate to arrive at the Audited Sales Tax. Any reported sales tax is subtracted from the Audited Sales Tax to arrive at the sales tax deficiency. The deficiency is entered as an accrual deficiency and the findings should be entered on the "Accrual Differences" schedule.

		(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)			
			Audited Sales - 1099K/CC Ratio (A/0.701087)	Audited Taxable to Gross Ratio	Audited Taxed Sales (B*C)	Audited Tax Collected (D*6%)	Reported Sales Tax	Reported Sales Tax - Marketplace Facilitator	Deficiency (E-F-G)			
Period End	1099Ks											
01/31/2015	\$ 69,390.78	\$	98,975.99	88.700%	\$ 87,791.70	\$ 5,267.50	\$ 2,000.00		\$ 3,267.50			
02/28/2015	77,310.71		110,272.63	88.700%	97,811.82	5,868.71	1,805.00		4,063.71			
03/31/2015	70,550.41		100,630.04	88.700%	89,258.85	5,355.53	1,900.00		3,455.53			
04/30/2015	75,959.76		108,345.70	88.700%	96,102.64	5,766.16	2,100.00		3,666.16			
05/31/2015	59,425.07		84,761.33	88.700%	75,183.30	4,511.00	2,400.00		2,111.00			
06/30/2015	64,001.57		91,289.06	88.700%	80,973.40	4,858.40	1,700.00		3,158.40			
07/31/2015	58,807.12		83,879.92	88.700%	74,401.49	4,464.09	2,225.00		2,239.09			
08/31/2015	49,005.10		69,898.74	88.700%	62,000.18	3,720.01	1,975.00		1,745.01			
09/30/2015	60,317.82		86,034.71	88.700%	76,312.79	4,578.77	2,150.00		2,428.77			
10/31/2015	62,639.87		89,346.79	88.700%	79,250.60	4,755.04	2,300.00		2,455.04			
11/30/2015	59,926.93		85,477.17	88.700%	75,818.25	4,549.10	2,400.00		2,149.10			
12/31/2015	52,191.44		74,443.60	88.700%	66,031.47	3,961.89	1,800.00		2,161.89			
Totals	\$759,526.58	\$	1,083,355.68		\$ 960,936.49	\$ 57,656.20	\$ 24,755.00		\$32,901.20	Total Sales Tax Deficiency		
CC Ratio	70.11%	\$	64,500.00	Total Transactions paid w/CC inclusive of tax, tip, gc								
		\$	92,000.00	Total Audited Sales exclusive of tax & tip								
		\$	81,759.00	Audited Taxable Sales - Prospective Period								
Audited T/G Ratio	88.87%	\$	92,000.00	Total Audited Sales - Prospective Period								

Figure 5.6 -1099K Prospective Records Example

In the narrative, the term “1099K ratio” must be used to describe the type of ratio used to calculate the Audited Gross Sales. If the taxpayer uses a marketplace facilitator to make sales, the 1099Ks of these marketplace facilitators must be included in the total of the 1099Ks used to arrive at the Audited Gross Sales. Also, the Audit Sales Tax should be offset by any sales tax reported by the marketplace facilitator.

Prospective Records-Additional Taxable Sales

If the prospective records identify any additional taxable sales, an error rate is calculated by the dividing the additional taxable sales by the audited sales for the prospective period. The error rate is applied to the monthly Audited Gross Sales to arrive at the additional taxable sales for the audit period.

Period	(A) Audited Gross Sales	(B) Additional Taxable Sales (A*.2989%)				
1/31/2020	98,978.99	295.85				
2/29/2020	110,272.63	329.60				
3/31/2020	100,630.04	300.78				
4/30/2020	108,345.70	323.85				
5/31/2020	84,761.33	253.35				
6/30/2020	91,289.06	272.86				
7/31/2020	83,879.92	250.72				
8/31/2020	69,898.74	208.93				
9/30/2020	86,034.71	257.16				
10/31/2020	89,346.79	267.06				
11/30/2020	85,477.17	255.49				
12/31/2020	74,443.60	222.51				
	\$ 1,083,358.68	\$ 3,238.16				
	0.2989%	\$ 275.00	Additional Taxable Sales-Prospective Period			
		\$ 92,000.00	Total Audited Sales-Prospective Period			

Figure 5.7-Prospective Records-Additional Taxable Sales Example

1099K Ratio using Industry Average

When the taxpayer does not maintain complete prospective sales records an “Industry Average 1099K Ratio” (industry average) is used. The industry average represents the average ratio of 1099K’s (includes sales tax & tip) to total gross sales (excludes sales tax & tip) of similar taxpayers. This ratio is applied in the same manner as the 1099K ratio used for prospective records.

The supervisor should contact headquarters to obtain an “Industry Average 1099K Ratio”. The request should include the taxpayer’s name, FEIN, assignment number, county, annual 1099K receipts and the possession of liquor license or not.

CHAPTER 6- POST-AUDIT PROCEDURES

This chapter of the manual describes the procedures that must be followed or considered, following the examination of a taxpayer's records.

Concluding and Summarizing Audit Work

At the conclusion of the field work, the auditor must prepare schedules that summarize the audit findings. These schedules must be sufficient to enable tracing of individual items found to be deficient to the final schedule of assessment by reporting period. These schedules (references) must be included in the Sales and Use Tax Report and all supporting schedules created outside of the Bureau's audit application software.

The auditor should provide the taxpayer all pertinent schedules and worksheets including the Sales and Use Tax report prior to submitting the audit for pre-review. Collectively, these workpapers support the basis of assessment. Ideally, these workpapers should be presented to taxpayer as the audit procedures are progressing. The Sales and Use report should be stamped as "Draft" using the watermark feature in the Bureau's audit application software.

Pre-Review Procedures

Upon conclusion of the fieldwork, the auditor will have a meeting with the taxpayer's representative (in person if practical) to discuss the audit findings and provide the sales and use tax report and schedules. The auditor should **not** provide the *Taxpayer's Acknowledgement of Post Audit Conference* form to the taxpayer at this time. The auditor should provide the taxpayer with **Sales and Use Report** along with any worksheets and schedules necessary to support the basis of the audit findings. The auditor should allow the taxpayer an opportunity to review the Sales and Use Tax report prior to the post audit conference. The auditor should be prepared to provide a detailed explanation of the basis for the audit findings. This includes providing the taxpayer with specific references to the law and regulations pertaining to the audit findings.

The auditor should explain to the taxpayer representative that the audit is being submitted for supervisory review, is subject to change upon review, and that no further documentation will be accepted. If the taxpayer provides records after the meeting, those records may need to be reviewed or a waiver obtained to have the necessary time to review. This will be evaluated by the supervisor on a case-by-case basis. In addition, the auditor will inform the taxpayer that once the supervisory review is complete, the auditor will contact the taxpayer to schedule a post audit conference either in person or by phone.

The auditor should gather all audit documents, the **Sales and Use Report**, the completed audit narrative, and verify that all required schedules, forms, and exhibits have been properly prepared for submission for pre-review. This includes proof reading, checking citations, checking header information, required signatures, and cross footing audit totals. The complete audit report

including narrative and exhibits must be submitted to the supervisor at least **45** days before the **Due to HQ** date.

The auditor will stage the audit to “Supervisor Review” and change owner to supervisor in PATH. Management personnel will complete the pre-review process within 30 days as per [Audit Assignment and Inventory Management Policy](#) and inform the auditor to post the audit as submitted or if adjustments are required.

Upon the pre-review:

Adjustments are required:

- The audit will be staged in PATH as “Rework” and owners changed back to the auditor.
- Any adjustments which result in an increase or decrease in the audit findings, the revised workpapers including the *Sales and Use Report* should be provided to the taxpayer’s representative with an explanation of the adjustment.
- The entire pre-review process will start over, so when the auditor resubmits the audit package for pre-review, the auditor will stage the audit to “Supervisor Review” and change owner to the supervisor in PATH.

No adjustments are required:

- The supervisor will change owner to the auditor in PATH.
- The auditor will stage the audit in PATH to “Conference”.
- A post-audit conference should be conducted and the final audit report submitted to management personal within 10 days of the completion of the pre-review process or as noted in the [Audit Assignment and Inventory Management Policy](#). Exceptions to extend timeline may be approved by the Regional Manager.

AUDIT REVIEW TIMEFRAME	
Auditor Submits for Pre-Review	45 Days Prior to <i>Due to HQ</i> Date
Supervisor/Manager Completes Pre-Review	30 Days or less
Auditor Conducts Post-Audit Conference and Submits Final Audit Report to Supervisor	10 Days or less
Final Regional Review to Submit to HQ	5 Days or less

Figure 6.1 Audit Review Timeframe

Post-Audit Conference Requirements

A post audit conference must be conducted for every audit including the completion of the Taxpayer's Acknowledgement of Post Audit Conference form.

A post audit conference should be held in person. In circumstances where a face-to-face conference cannot be held, the auditor must document their attempts to set up an in-person conference. A telephone post-audit conference should be conducted for all out of state audits.

The taxpayer may record the post audit conference. At the taxpayer's request, the Department will provide a recorder and a copy of the recording.

The auditor **must do** the following at each post audit conference:

- Record date, name of those participating in the conference, the location of the conference and the length of the conference. This information must be included in the audit narrative.
- Inform the taxpayer that the audit findings are subject to further review and possible correction by the Bureau.
- Determine areas of disagreement and reasons for such disagreement.
- Explain in the audit narrative the taxpayer's reasons for disagreement as they relate to the various audit findings.
- Present the taxpayer with a *Taxpayer's Acknowledgement of Post Audit Conference* form. A template of this form is located in the Bureau's audit application software. This form will identify the audit period, areas of deficiency, and corrective recommendations for the areas of deficiency.
- Advise the taxpayer that they will receive a Notice of Assessment that will include the amount of the assessment, interest, penalties, credits, and any payment (made before the assessment is issued) by U.S. mail. The taxpayer should be informed that interest and penalties will be separately stated and explained on the assessment notice.
- Inform the taxpayer of their appellate rights and that the appeal rights are explained on the "*Notice of Assessment*". These rights and procedures are described in more detail below.
- Request the taxpayer to complete the *Taxpayer's Acknowledgement of Post Audit Conference* form and signify agreement, disagreement in part, or disagreement entirely with the audit findings. The taxpayer may elect to leave the form blank and merely sign. If the taxpayer declines to sign the form, the auditor should note on the form and in the narrative the date, time and whom the form was presented to, and that the taxpayer declined to sign the form. The auditor must inform the taxpayer that completion of the form does not waive any rights to appeal, no matter what is indicated.

- Inform the taxpayer that a complete Basis of Assessment (audit report) will be sent with the Notice of Assessment.
- Prior to the post-audit conference, the auditor should verify if the taxpayer wants the Audit Basis of Assessment (audit report) uploaded to myPATH; refer to [Notice of Assessment & Audit Basis of Assessment](#) procedures.
- The auditor will review the formal handout [Notice of Assessment Audit Basis of Assessment](#). The auditor should confirm all information.

A copy of the completed *Taxpayer's Acknowledgement of Post Audit Conference* form should be given to the taxpayer. If a copier is not available, the auditor is to inform the taxpayer that a copy will be sent to them prior to the audit being submitted for processing.

Payments Received from the Taxpayer During an Audit

If a check is received from the taxpayer anytime during the audit (including the post audit conference), the auditor will create a payment voucher in PATH and provide it to the taxpayer along with instruction on where to mail payment; refer to [Checks Received in the Field](#) procedures.

The auditor is not to solicit payment for tax liabilities during the conduct of an audit.

The auditor should inform the taxpayer that any payment received by check that exceeds \$1,000 would result in an EFT penalty. To avoid the penalty, the taxpayer should pay the assessment when the Notice of Assessment arrives.

Taxpayer Electronic Payment

If the taxpayer wants to make an electronic payment through [MyPATH](#) before the audit has been closed, the auditor should inform the taxpayer to choose the last reporting period of the audit period and make a return payment. The taxpayer will:

- Select "Make a Payment" hyperlink under their sales and use tax account.
- Select payment type:
 - Choose an existing payment channel or Select "NEW".
- Enter and confirm the amount.
- Submit

Post-Audit Conference by Phone

A post audit conference by phone is allowable when conducting a post audit conference in person is not practical due to proximity or necessity. In addition to the preceding requirements for a post audit conference held in person, the following requirements must also be performed:

- Prior to a post-audit conference by phone, a copy of the *Taxpayer's Acknowledgement of Post Audit Conference* form, along with all schedules necessary to explain the audit findings should be sent to the taxpayer.
- The taxpayer should be asked if they received and reviewed the form and schedules. The taxpayer's response should be included in the narrative.
- After the post-audit conference, the taxpayer must be sent a *Post-audit Conference by Phone* letter signed by the regional manager. This letter will state the names of those who participated in the post-audit conference, the date of the conference and the assessment amount.
- The Post Audit Conference by Phone Letter is letter must be included in the audit report as an exhibit and discussed in the narrative.
- The original *Taxpayer's Acknowledgement of Post Conference* form should be sent to the taxpayer along with a self-addressed stamped envelope. The taxpayer should be instructed to complete and return the form to regional office.

Note: If the taxpayer provides the signed *Taxpayer's Acknowledgement of Post Audit Conference* form electronically immediately following the conference, then the Post-Audit Conference by Phone letter will not be required.

Inability to Schedule Post-Audit Conference

A post-audit conference by certified mail may only be conducted after a reasonable effort to conduct the conference in person or by telephone has been made. The auditor must document all efforts to contact the taxpayer (including phone calls, faxes, in person visits, emails, and mailed correspondence) to conduct the conference in person or by telephone and must include the documentation in the audit report. Such documentation will include a chronological listing of attempts made by the auditor, supervisor, or regional manager to contact the taxpayer to set up the post audit conference.

Information provided to the taxpayer through voicemail **does not** constitute a post audit conference under any circumstances.

In these situations, a post-audit conference will be scheduled in the regional office at a date and time decided by the auditor and their supervisor. The taxpayer will be informed of the scheduled post-audit conference in a letter sent through certified mail. The taxpayer should be given at least two weeks advanced notice of the schedule date.

Inability to Schedule Post-Audit Conference Letter

An *Inability to Schedule Post Audit Conference Letter*, signed by the regional manager must be sent via certified mail to the taxpayer along with all pertinent schedules necessary to explain the audit findings. A *Taxpayer's Acknowledgement of Post Audit Conference* form should be completed and included with the letter. The date used on the form should be the scheduled

date of the post-audit conference. A copy of the form and letter must be included as an exhibit and discussed in the narrative. A template of this letter is located in the Bureau's audit application software.

The letter must:

- Explain that the subject audit has been completed.
- Formally notify the taxpayer of the time and date that the post-audit conference will be conducted in the regional office.
- Inform the taxpayer that the deficiency, interest, penalties, and the taxpayer's right to appeal will be included on the Notice of Assessment.
- Specifically identify the enclosed worksheets and schedules included with the letter.
- Reference the post-audit conference form.
- Indicate that the letter will be considered the close of the audit in the event the taxpayer fails to attend the scheduled post-audit conference.

Other Post-audit Considerations

At the conclusion of the audit work, the auditor should discuss with the supervisor the appropriateness of:

- Requesting or referring additional audits
- Referring the assignment to the Office of Criminal Tax Investigations
- Applying major civil penalties.

Audit Referrals

The auditor may discover, during pre-audit planning and during the course of the fieldwork, other entities that should be referred for audit. Procedures for identifying potential audits and making an audit referral are discussed below:

Audits of Affiliated Companies

The auditor must evaluate the necessity to conduct an audit of affiliated companies.

An affiliated interest exists when two corporations, associations, partnerships, proprietorships, or other businesses, in which one corporation, association, partnership, proprietorship, individual or other business owns more than 50% of the stock or assets, including inventory, machinery and equipment of the remaining corporation, association, partnership, proprietorship or other business. Also, the common ownership of more than 50% of the stock or assets of each of two or more business entities results in an affiliated interest between the two commonly owned entities.

The auditor must:

- Determine if the affiliate(s) is registered for sales and use tax in Pennsylvania and if so, review the reporting history for compliance. If the affiliate(s) is not in compliance (i.e., delinquent returns), an audit must be conducted.

- When common management (e.g., parent of sister corporation) is responsible for the reporting of sales and use tax for affiliated companies and the potential exists for similar errors identified during the current audit, an audit must be conducted.

The auditor should complete an *Audit Potential Worksheet* to request the issuance of the appropriate assignment. The template of the form is available in Bureau's audit application. The auditor should request the audit assignment as soon as the potential for a referral audit assignment is identified.

Note: Audit assignments for these referrals will not be made to the originating auditor unless it is a collateral audit, or the Program Administrator authorizes the assignment.

Audits of Other Companies

Audit referrals may also be generated because of a change in ownership of the entity under audit. In these circumstances, audit referrals must be made in accordance with the instructions found under **Chapter 8 – Audit Policy, Entity Changes**.

Audit referrals may also be generated when the auditor discovers during the expense examination taxable payable transactions where the vendor is not charging sales tax. When conducting a sales examination, referrals should be made when exemption certificates are construed as being accepted in good faith by the vendor under audit, but independent research of the purchaser's activities are not consistent with the exemption claimed.

Audit Potential Worksheet

The *Audit Potential Worksheet* is an auditor's primary tool used to gather information about a taxpayer for an audit referral. The completed worksheet allows for a systematic review of the taxpayer's business activities as well as a determination of whether or not the entity listed on the worksheet meets the Bureau's audit criteria. The worksheet is available as a document template in the Bureau's audit application.

Submitting an Audit Referral

The auditor will submit an audit referral work item along with *Audit Potential Worksheet* by following the [Audit Referrals](#) procedures for PATH. The auditor will either send the referral to their supervisor or regional manager (owner of work item). The supervisor and/or regional manager will review referral work item and forward to the Program Administrator (owner) for further review.

The Program Administrator will assign work item to program specialist with the ST Division who will review the information and issue an assignment if an audit is warranted.

Collateral Audits

Collateral audits are audits on the same taxpayer for a different tax type, such as Employer Withholding (WTH), Public Transportation Assistance Tax (PTA), E-911, Vehicle Rental Tax (VRT), Wine Excise Tax (WET) and Consumer Fireworks Tax (CFT).

Note: The auditor who requested the collateral audit will also conduct the audit.

Submitting Request for a Collateral Audit

The auditor will submit a collateral audit request work item along with the *Audit Potential Worksheet* following the [Audit Collaterals](#) procedures in PATH. The auditor will either send the request to their supervisor or regional manager (owner of the work item). The supervisor and/or regional manager will review the collateral audit request work item and forward to the Program Administrator (owner) for further review.

The Program Administrator will assign work item to program specialist with the ST Division who will review the information and will issue an assignment if an audit is warranted.

Criminal Tax Program

In most instances, tax crimes involve fraud, which is a crime of “commission”. In other words, the taxpayer must act in a manner that conceals or suppresses the true tax liability. The taxpayer commits a form of theft if trust fund money is collected and commingled with the taxpayer’s funds to keep the business operating. The taxpayer is committing theft by failure to make required disposition of funds.

The taxpayer can also commit crimes of “omission”. In these situations, a taxpayer can commit a crime by failing to act, such as not filing a return or not paying tax that is due. Crimes of omission are not discussed in this manual since the method of detection is self-evident, but they do, constitute basis for criminal tax referral.

What is Fraud?

Fraud is generally defined as an act of deception or misrepresentation of material facts, or failure to act when good faith requires expression. It can be defined more simply as wrongful or criminal deception intended to result in financial or personal gain.

Tax fraud usually involves false documents, returns, and/or statements and may include attempted evasion, conspiracy to defraud, aiding and abetting, or counseling of fraud with the intention of stealing trust fund monies that have been collected. Elements common to all tax fraud cases involve the following:

- An understatement of tax liability or a failure to file.
- Willful intent to evade taxes.
- Course of action demonstrating the taxpayer’s intent.

It is emphasized that the mere existence of an understatement of tax liability is not indicative of a taxpayer’s willful intent to evade taxes. Willful intent is usually shown by a pattern of understatements, deceit, concealment, misleading acts, misrepresentation, and other acts evident of willfulness. Acts in either the past or present that are representative of the taxpayer’s state of mind when the possible fraud(s) occurred are critical to determining whether the taxpayer acted with willfulness. Since the burden of proof in any fraud case rests on the Commonwealth (see below), the Department must fully document each of these acts to establish any alleged fraud.

Guidelines for Determining Tax Evasion Audits

The Department has the burden of proof in establishing that the taxpayer engaged in a willful attempt to evade the tax. In civil cases, willfulness may be shown by a preponderance of the evidence, whereas criminal cases must be proven beyond a reasonable doubt.

Examples of scenarios that could involve tax evasion during an audit:	
<ul style="list-style-type: none">Failure to report tax collected as shown on invoices.	<ul style="list-style-type: none">Report less tax than shown on the accrual account.
<ul style="list-style-type: none">Misappropriation of tax monies.	<ul style="list-style-type: none">Paying employees in cash (No withholding of personal income tax)
<ul style="list-style-type: none">Failure to deposit all sales tax and employer withholding receipts.	<ul style="list-style-type: none">Submitting a false document or affidavit.
<ul style="list-style-type: none">Failing to keep proper books and records.	<ul style="list-style-type: none">No records, poorly kept record, two sets of records, attempts to falsify records, or altering records.
<ul style="list-style-type: none">Destroying books and records without a plausible explanation or refusal to make certain records available.	<ul style="list-style-type: none">Knowingly making false, misleading, and inconsistent statements.
<ul style="list-style-type: none">Willful failure or refusal to collect tax.	<ul style="list-style-type: none">Bribery with money or other items or services of value.

Figure 6.1- Tax Evasion Scenarios

Since it is necessary to determine whether the taxpayer's actions are willful, it is important to show a consistent pattern of tax evasion. The mere failure to report tax collected on sales of an infrequent nature does not necessarily constitute tax evasion. When auditors have identified discrepancies, auditors must ask the taxpayer such questions as to how, why, when, where, and who in order to decide whether the audit should be discussed with the appropriate supervisor concerning fraud.

Imposition of Tax Evasion Penalties

Under Pennsylvania law, the Department may assess a penalty in the amount of 50% of the amount of tax evaded. Specifically, 72 P. S. § 7267(b) provides: "Any person who willfully attempts, in any manner, to evade or defeat the tax imposed by this article . . . shall, in addition to other penalties provided by law, be liable for a penalty equal to one-half of the total amount of the tax evaded." This provision is separate from and in addition to the penalties imposed for late filed returns. When interpreting what conduct constitutes a willful attempt to evade tax, the court in Zimmerman v. Commonwealth, 68 Pa. Commw. 336, 449 A.2d 103 (1982), "looked for guidance to Section 302(g) of the Crimes Code, 18 Pa. C. S. § 302(g), which defines willfulness as acting "knowingly." Knowingly is defined under Section 302(b)(2)(i) of the Crimes Code as being "aware that . . . conduct is of that nature." Accordingly, to support the

imposition of tax evasion penalties, the Department must show that the taxpayer was aware that the conduct in question involved an evasion of tax.

Possible Indications of Fraud

Include:	
▪ Willful failure to consistently collect tax on taxable transactions.	▪ Deliberately altering books and records to misrepresent tax liability.
▪ The consistent understatement of figures on tax returns.	▪ Willful failure to maintain records.
▪ Destroying or refusing to turn over records when the Department has reasons to believe a tax liability can be established.	▪ Consistently collecting tax and not remitting a part or all of the tax collected.
▪ Failure to file returns	▪ Aiding and abetting a taxpayer to defraud the Commonwealth of tax revenues.

Figure 6.2-Possible Indications of Fraud

Criminal Referral Criteria

All audit assignments involving the same taxpayer, including collateral assignments, must be simultaneously referred for criminal investigation to the BETA Criminal Tax Division even if only one of those audit assignments meets the criminal referral criteria.

Additional referral guidelines include:

- Where feasible, document and schedule all available invoices that represent taxes collected and not reported. This will support and strengthen the criminal referral.
- Trust fund deficiencies established through projections should be referred regardless of the method used to establish the liability.
- If a payment is made prior to assessing the tax deficiency, the regional manager is to contact the Program Administrator for a referral decision.
- Failure to carry out reasonable tax collecting, accruing, reporting, and/or paying responsibilities.
 - **For example:** An initial audit discloses that the taxpayer was not collecting sales tax

in one or more situations; the taxpayer was fully apprised of tax collecting responsibilities; and upon subsequent audit, it was discovered that the taxpayer continues to make such sales and not collect the tax due.

- Failure to keep proper books and records; poorly kept records; two sets of records; attempts to falsify or alter records; refusal to make records available; destroying books and records.

If any one of the above criteria is met, all audit assignments involving the taxpayer in question must be recommended for referral to the BETA Criminal Tax Division. A memorandum must be attached to the *Additional Headquarters Processing Request* form stating the reason for the referral.

Assignments should not be referred to BETA Criminal Tax Division based on assessments resulting from nontaxed sales or use tax.

Post-Audit Conference on Criminal Referrals

A post-audit conference will be held with a Bureau representative at the taxpayer's place of business to explain the civil audit findings, make recommendations to correct areas of noncompliance, and provide the supporting schedules.

Audits referred on out-of-state entities can follow the guidance for holding a post-audit by phone.

Criminal referral should not be discussed at the post audit conference. The decision to make the criminal tax referral will be made upon regional review, after the conclusion of the audit.

If, during the course of the audit or at the post audit conference, the taxpayer questions the possibility of a criminal referral, a statement may be made citing the audit could be referred pending further review.

Major Penalties

72 P.S. § 7267(b) states any person who willfully attempts, in any manner, to evade or defeat the tax imposed by this Article shall, in addition to other penalties provided by law, be liable for a penalty equal to one-half of the total tax evaded.

Therefore, the determining factor for imposing major penalties is not a dollar threshold but the willful attempt of the taxpayer to evade the tax. Willful attempt is defined as knowing or being aware of the conduct. To impose major penalties, the Bureau must demonstrate the taxpayer knew or was aware of the under-reporting of the sales tax.

Following are examples where the Bureau would consider the taxpayer willfully attempted to evade the tax and major penalties should be imposed.

- The under-reporting of sales tax was assessed in prior audits.
- Sales tax associated with a non-filed return.
- Consistent pattern of under-reporting sales tax during the audit period.

- The under-reporting of sales tax was a significant percentage of the total reported sales tax. (ex. The reported sales tax is \$15K for the audit period, but the unreported sales tax is \$25K).

Following are examples of scenarios where the Bureau would **not** consider the taxpayer willfully attempted to evade the tax and major penalties should **not** be imposed.

- The under-reporting of sales tax was a result of a clerical or administrative error.
- The sales tax is consistently over and under reported netting to zero tax due.
- The under-reporting of sales tax was an insignificant percentage of the total reported sales tax. (ex. The reported sales tax is \$5 million for the audit period, but the unreported sales tax is \$50K).
- The under-reporting of sales tax was result of taxpayer's incorrect application of the statute or regulation. (ex. cash vs. accrual method).

The auditor should ask themselves the following questions when it comes to determining willful attempt by the taxpayer to evade tax:

- Was the under-reporting of sales tax a result of an administrative or clerical error (i.e., transposing of numbers, generating the wrong report etc....)?
- Was the under-reporting of sales tax identified and assessed in prior audits?
- Is there a consistent pattern of under-reporting of sales tax (e.g., every month)?
- Does the taxpayer have a reasonable explanation for the under-reporting of sales tax?
- In addition to the under-reporting, is the taxpayer over-reporting resulting in the netting of zero tax due?
- Was the under-reporting a result of incorrect application of the statute/regulation or erroneous guidance from the Department?
- Is the under-reporting of sales tax a significant or insignificant percentage of the sales tax collected?

Major penalties should not be discussed at the post audit conference. The decision to impose major penalties will be made upon regional review, after the conclusion of the audit.

If, during the course of the audit or at the post audit conference, the taxpayer questions the possibility of major penalties, a statement may be made citing major penalties may be imposed pending further review.

Review and Submission of Audit Report to Headquarters

After the post-audit conference is held, the auditor will prepare the final audit report for submittal to the supervisor. The final **Audit Report** includes all audit documents that will be include in the Bureau's audit application software.

The audit documents include:

-
- *Sales and Use Report*

- Completed audit narrative
- All required schedules
- All forms
- All exhibits

Final Review

The auditor will stage the audit in PATH to Regional Review and change the owner to the supervisor. The supervisor conducts the final review of the audit package and generate another the *Sales and Use Report* which should be stamped as “*Final*” using the watermark feature in the Bureau’s audit application software. The supervisor will change the ownership in PATH to Clerk/Management Tech. The clerk/Management Tech will verify information from the audit package to information in PATH using:

- Audit- Attributes Panel
- Audits tab-Attributes subtab
- Customer Springboard
- Account Springboard

Creating the Audit Report and Submitting to Headquarters

The clerk/management tech will create an *Audit Report* (Single PDF) and save the PDF document as “Audit Assignment Number”. The clerk/management tech will create a folder with the assignment number within **P:\RcvdHQ\STD**. The clerk/management tech will transfer the following files to this folder:

- Audit file (TMZ)
- Copy of Audit Report-Final
- Audit Experience Evaluation Survey (Region)
- Sales and Use Report -Final (Excel file)
- Additional Headquarter Processing Request form (if applicable)
- PIT Referral (if applicable)
- Sales Schedule (Excel File) (if applicable)
- Purchase Schedule (Excel File) (if applicable)

The clerk/management tech will stage the audit in PATH to “HQ Review” and change the owner to the Program Administrator.

Appeal Process

Taxpayers may appeal any audit assessments. Instructions for filing an appeal are provided with the assessment notice. Appeals must be filed within designated time frames (See [Time Limitations on Filing Petitions for Appeal \(REV-1799A\)](#)).

Board of Appeals

All appeals of audit assessments are initially filed with the Department of Revenue’s Board of Appeals.

In order to file an appeal, the taxpayer must submit a Petition for Reassessment to the board postmarked within 60 days of the assessment notice date. The last day to file the appeal will be clearly indicated on the assessment. A petition may be filed by mail or electronically through the Board's web page at <https://www.boardofappeals.state.pa.us>. The taxpayer may use [Board of Appeals Petition Form \(REV-65\)](#), and [REV-39, Sales and Use Tax Appeal Schedule](#). The petition must state the basis of appeal, accompanied by an affidavit, and signed by the petitioner.

The Board will review submitted evidence and conduct hearings as necessary to decide the merits of the taxpayer's case. After considering all evidence, the board will then issue a written decision to the taxpayer.

Board findings issued to specific taxpayers must be adhered to in follow up audits unless it is evident that the facts presented to the Board of Appeals differ from the facts in the current audit.

If the taxpayer disagrees with the findings of the Board, the taxpayer may appeal the case to the Board of Finance and Revenue.

Board of Finance and Revenue

The Board of Finance and Revenue (BFR) is the next level of appeal for taxpayers after the Board of Appeals. The Board consists of three members. Two members are appointed by the Governor and confirmed by the Pennsylvania Senate. The State Treasurer or their designee is the third member and is Chair.

Upon receiving the written decision from the Board of Appeals, the taxpayer has 60 days to file an appeal with BFR. BFR will review submitted evidence and conduct hearings as necessary to decide the merits of the taxpayer's case. After considering all evidence, the Board then votes on the merits of the case. The board will then issue a written decision to the taxpayer.

BFR's decision on a specific case for a specific taxpayer must be adhered to in any follow up audit unless the facts upon which BFR made their decision differ from the facts in the current audit or the Department appeals the BFR decision. Prior to setting aside a BFR decision, contact HQ first. Copies of BFR decisions may be requested through headquarters. BFR files relating to refund or appeal requests initially filed with BOA after January 2003 may be viewed on the RAPS system.

If the taxpayer disagrees with BFR's decision, the taxpayer may appeal to the Commonwealth Court of Pennsylvania.

Commonwealth Court of Pennsylvania

The Commonwealth Court has appellate jurisdiction over appeals on decisions made by state administrative boards like the Board of Finance and Revenue. A hearing before this court represents actual litigation where the Office of Attorney General represents the Department. The taxpayer has 30 days from the postmark date of the BFR decision to file an appeal at this level. The court will render a written decision describing the issues and the legal basis for its decision. The taxpayer may elect to pursue the matter to the Pennsylvania Supreme Court and beyond if Commonwealth Court rules in favor of the Commonwealth.

In certain cases, the Department and the taxpayer will settle out of court. These settlements are nonbinding on future audits and only pertain to the specific case at hand.

CHAPTER 7-AUDIT REPORT

Purpose

The purpose of the audit report is to document audit findings and to provide a clear basis of assessment to all parties involved in a potential appeal. These parties include the taxpayer, practitioners, administrative boards, and state courts. Interested parties also include auditors and management staff who may be called to testify in hearings or who are involved in a follow up audit. Therefore, an audit report is intended to be a self-sustaining record. The audit report must independently account for all events that impact the findings of the audit.

Content

The audit report is made up of a narrative and supporting documentation. The narrative provides a written explanation of audit procedures, audit findings, and the legal basis for any assessment. Supporting documentation includes schedules, reports, exhibits, and forms. This documentation is intended to summarize, itemize, and illustrate the audit findings.

Each piece of documentation within the report, including the narrative, is considered evidence. The evidence presented in the audit report supports the Department's issuance of a tax assessment. Therefore, audit documentation must be prepared in such a way that it can rebut challenges made during an appeal by accurately depicting the facts on which the assessment is based. The Bureau has implemented certain requirements that must be followed in the preparation of each part of the audit report with this objective in mind. These requirements are listed below.

SLS Narrative Report and Audit Findings

The audit narrative is the auditor's written explanation of audit procedures and the legal basis for assessment. The narrative should be written as the audit progresses. For instance, the pre audit section of the narrative should be prepared as soon as the conference is completed so that pertinent details about the discussion are retained. This will allow the auditor to record events timely and accurately. It will also contribute to efficient conduct of the audit.

The narrative cites the provisions of the law and Department regulations that pertain to the audit findings. It also serves as the document that connects the entire audit report together by referencing all other supporting documentation. This is the mortar that cements the various supporting data into a meaningful audit report.

General Rules

There are general rules of "do's and don'ts" that apply to the body of the narrative.

Narrative Do's

- Do cite laws and regulations where appropriate. This includes narrative discussions of

areas contested by the taxpayer, areas of large deficiency, and any area of potential appeal as well as cites that govern the taxpayer's business activities. Cites should be as specific as possible and must be written in the proper format (See [Chapter 3. Checkpoint](#)).

- Do reference and explain all schedules and exhibits. The name of the document as listed on the *Audit Package Checklist* should be the same name of the document referenced in the narrative.
- Do use correct spelling, grammar, and punctuation.
- Do write the narrative in third person (the auditor, the taxpayer, etc.)
- Do consult this manual in the preparation of the narrative.

Narrative Don'ts

- Don't reference supervisors, management staff, or headquarters personnel in the narrative. However, supervisor or manager attendance at a pre or post audit conference must be referenced.
- Don't reference internal memos, documents, or email. These items are confidential. Internal documents may be referenced on the *Conflict of Interest Statement and Auditor's Comments* form located in the Bureau's audit application software.
- Don't reference letter rulings in the narrative unless the Office of Chief Counsel has directly addressed the ruling to the taxpayer under audit.
- Don't use "canned" narratives. "Canned" narratives are prewritten narratives that often contain data from a different audit report.
- Don't wait until the conclusion of the audit to begin writing the audit narrative.

Sections of the Narrative

The auditor will use a Microsoft Word template ([Narrative Report of Audit Findings](#)) to write the narrative. This template is available in the Bureau's audit application software.

Audit Summary

This section of the narrative summarizes the net audit deficiency by tax type and tax category including a reference of the various reports within the Sales and Use Report.

Pre-Audit:

General Information

Legal Name and Trade Name

The taxpayer's legal and trade names must be identified. These can be inserted from the "Taxpayer Information" screen in the Bureau's audit application software through the macro available in the *Narrative Report and Audit Findings* template.

Business Information

This section of the narrative is intended to provide clear description of the taxpayer. The auditor will complete the following:

- **Entity type** (*select from drop-down box*).
 - The type of entity must be specifically stated. The most common types of entities are sole proprietorships, partnerships, corporations, subchapter "S" corporations, joint ventures, associations, limited liability partnerships, and limited liability companies. If the entity is a corporation, the date and state of incorporation identified on the *Bureau of Audit's Registration Verification* form must also be stated.
- **State of Incorporation/Formation** (*select state from drop-down box*).
- **Formation Date**
- **Headquarter Location**
 - Detail the address of Headquarter location.
- **PA Business Start Date**
- **Pennsylvania Locations**
 - Specifically indicate the number of the taxpayer's Pennsylvania business locations. If the taxpayer has more than one Pennsylvania location, an exhibit detailing the addresses of these locations and a brief description of their activities must be included in the audit report and referenced in the narrative.
- **Local Tax Jurisdiction** (*select from the drop-down box*)
 - None
 - Allegheny County
 - Philadelphia County
 - Both

Engagement Letter (*select from the drop-down box for exhibit identity*)

The engagement letter must be specifically reference in the narrative by exhibit.

- **Engagement Letter Date**
 - The date the letter was issued needs to be entered in this field.

Initial Contact

This is the first date when the auditor attempted to contact taxpayer.

Registration *(select from the drop-down box)*

- Bureau of Audit Registration Verification form.

Audit Review of Third-Party Credits

Enter the due date when the taxpayer must provide the records.

Publication Outlining Bill of Rights *(select from the drop-down box)*

This section of the narrative must indicate that the taxpayer either received a copy of the REV-554 Disclosure Statement of the Department's and Taxpayers' Rights and Obligations or a copy was provided at pre-audit conference.

Accounting System

- **Type of Accounting System** *(select from the drop-down box)*
 - Handwritten
 - Computerized
 - Handwritten and Computerized
- **Basis of Accounting Income Tax** *(select from the drop-down box)*
 - Accrual
 - Cash
- **Basis of Accounting Sales and Use Tax** *(select from the drop-down box)*
 - Accrual
 - Cash
- **Accounting Period** *(select from the drop-down box)*
 - Calendar Year
 - Fiscal Year Ended

Confirmation Letter *(select from the drop-down box for exhibit identity)*

The Confirmation Letter must be specifically reference in the narrative by exhibit and indicated in this section.

- **Confirmation Letter Date**
 - Enter the date the letter was issued to the taxpayer.

Audit Site & Record Location Request *(select from the drop-down box)*

Identify location of audit and records for the audit.

Record Removal Receipt (Received)

Enter the date of the signed *Record Removal Receipt*.

Audit Plan *(select from the drop-down box)*

Indicate yes or no if audit plan(s) was issued.

Enter the last date audit plan was signed.

Waiver Period

The Waiver Period is a populated field. This field contains a macro which pulls data from the Bureau's audit application software "Taxpayer Information" section.

- **Waiver Expiration**
 - The Waiver Expiration is a populated field. This field contains a macro which pulls data from the Bureau's audit application software "Taxpayer Information" section.

Areas of Discussion

- The date and place of follow up contact to set an appointment for the conference must be described. If numerous attempts were necessary to establish contact, then this section of the narrative should reference an exhibit that documents each attempt.
- Any taxpayer's requests to postpone the audit for a significant length of time should be in writing and exhibited in the audit report.
- The audit period identified. If the defined period is not in conformity with the standard audit period (three years plus the current), then this section of narrative must provide an appropriate explanation.
- Waivers signed by the taxpayer that extend the audit period must be referenced in this section with an explanation for executing the waiver.
- Information regarding entity changes, affiliates, collateral audits, and bankruptcy must be included in this section of the narrative.
- Information on bankruptcy must include the bankruptcy date, cause number, bankruptcy type, and bar date.
- Issues regarding nexus or information provided by the taxpayer via a Business Activities Questionnaire must be addressed.
- Also, any documentation related to an entity change such as any bulk sales agreement or merger agreement should be included as an exhibit.

Other Taxes/Fees/Licenses

- List other tax licenses and fee in this section along with License (Account) Number that will be examined as part of the audit.
 - i.e., PTA and Employer Withholding

Sales & Use Tax License Information

Filing Frequency

Indicate either monthly, quarterly, or semi-annual.

Filing Detail Reference

Enter Reference # from Sales and Use Report

Accrual Difference Reference

Enter Reference # from Sales and Use Report

Number of Returns Filed

Enter the number of returns filed during the audit period.

Number of Returns Filed Late

Enter the number of returns that were filed late during the audit period.

Number of Non-Filed Returns

Enter the number of non-filed returns during the audit period.

Sales Tax Reported *(select from drop-down box for Tax Code for sales tax reported).*

Indicate either S00, S02 and/or S51, none.

Use Tax Reported *(select from drop-down box for Tax Code for use tax reported).*

Indicate either U00, U02 and/or U51, none.

Areas of Discussion

- Describe any detail relating to non-filed returns, revoked sales and use tax license, or other related information.

Pre-Audit Conference

The purpose of this section of the narrative is to document details of pre-audit conference with the taxpayer and/or the information discussed with the taxpayer prior to the beginning of the audit.

Date

List the date of conference.

Time

List the time of the conference.

Length

Indicate how long the conference lasted.

Conference Type *(select from the drop-down box)*

- On site
- Virtual
- Letter
- Phone

Taxpayer's Representative(s):

The names and titles of attendees for the taxpayer must be included in this section. This section must also indicate if any of the taxpayer's representative were operating under "Power of Attorney" authorization.

Department's Representative(s):

The names and titles of attendees from the Department must be included in this section.

Areas of Discussion

- Detail any other information pertaining to the Pre-Audit Conference such as plant tour arrangements.

Business Activities

This section of the narrative is intended to provide a clear description of the business operations such as retailer, construction contractor, manufacturer, etc. and to describe any products or services provided.

If the taxpayer is a manufacturer or processor, then a general description of the manufacturing operation must be included in the narrative or exhibited in the audit report. The description must identify the first and last stage of the manufacturing operation. The description should also discuss any areas of the operation that require additional clarification. A plant diagram can also be included as an exhibit to help clarify the manufacturing process.

Local Tax Jurisdiction(s):

- Select from the drop-down box for any local jurisdiction business activities:
 - None
 - Allegheny County
 - Philadelphia County
 - Both

Taxable Sales and citation(s)

This section of the narrative will identify the taxpayer's taxable sales. The statute and/or regulations governing the taxpayer's business activities must be cited.

Nontaxable Sales citation(s)

This section of the narrative will identify the taxpayer's nontaxable sales. The statute and/or regulation governing the taxpayer's business activities must be cited.

Taxable purchases and Citation(s)

This section of the narrative will identify the taxpayer's taxable purchases. The statute and/or regulations governing the taxpayer's business activities must be cited.

Nontaxable Purchases and Citation(s)

This section of the narrative will identify the taxpayer's nontaxable purchases. The statute and/or regulations governing the taxpayer's business activities must be cited.

System Survey

The purpose of this section of the narrative is to provide a description of the taxpayer's financial records used to document the audit trail of sales and purchase transactions from the source documents through the taxpayer's accounting system to the sales and use tax return. It is also to provide an overview of all available records. All records referred to in the "*Audit Procedures*" section of the narrative must be addressed as part of the system survey. The following items must be addressed in this section of the narrative:

Sales and Sales Tax Audit Trail

This section must describe a step-by-step explanation that traces the gross sales and taxable sales information reported on the sales and use tax return from the sales source document through the accounting system to the return.

Sales Tax Records Provided

Document name and Exhibit

Detail the list of records provided by the taxpayer that were used in preparing the sales portion of the sales and use tax return. Identify the exhibit if record(s) are included in the audit report.

Purchases and Use Tax Audit Trail

This section must describe a step-by-step explanation of the taxpayer's purchases. The auditor should trace the taxpayer's purchases information from the source document through the accounting system to the return.

Use Tax Records Provided

Document Name and Exhibit

Detail the list of records provided by the taxpayer that were used in preparing the use tax portion of the sales and use tax return. Identify the exhibit if record(s) are included in the audit report.

Areas of Discussion

This section must describe any records not provided or further detail of the records that were provided.

Audit Procedures & Adjustments

Sales Tax Phase

Gross Sales Examination

The narrative must describe the results of verifying gross sales as reported on the tax returns to the appropriate federal or state income tax returns and the general ledger for the audit period.

Description (Select from the Drop-Down Box)

Indicate the following:

- No Difference
- No significant difference noted.
- Additional state taxable sales
- Additional Allegheny County local taxable sales
- Additional Philadelphia County local taxable sales

Note: If more than one area of deficiency in gross sales, use separate line for each description.

Gross Sales Difference

Indicate the amount of any significant discrepancies in the reported gross sales.

Reference # and Report Title

Enter the *Reference Number* and report title as indicated in the “Sales and Use Tax Report”. The “Accrual Differences” schedule as well as separate schedules to support any significant discrepancies must be referenced in the narrative.

Details of Review

In the open box section, the auditor must provide a clear explanation of the records used to verify reported gross sales as well as an explanation of any discrepancies. The records used in the reconciliation must be the same records referenced in the System Survey.

If federal or state returns are not available for the verification of gross sales, the narrative must disclose that a *Request for Financial Records* was provided to the taxpayer and explain the reasons the records were not provided.

Other sources used to verify gross sales in the absence of federal or state returns must be specifically identified.

The audit report must provide an approximation of the number of sales transactions per month and identify how the approximation was determined.

Sales Tax Accrual

The narrative must clearly state the findings of comparing the taxpayer's reported sales tax to amounts recorded in the taxpayer's sales tax accrual records and general ledger accounts.

Description *(Select from the Drop-Down Box)*

Indicate the following:

- No differences
- Unreconciled Difference
- No audit findings were established.
- Sales tax discount disallowed.
- State sales tax deficiency
- State sales tax credit
- Local sales tax credit
- Disallowed bad debts.

Note: If more than one area of deficiency in sales tax accrual, use separate line for each description.

Tax Accrual Difference:

Enter the discrepancies or errors in the reporting of sales tax.

Reference # and Report Title

The narrative must reference the "Accrual Differences" schedule and "Accrual Error" schedule along with Reference Numbers from the "Sales and Use Tax Report". The records used in the reconciliation must be the same records referenced in the "*System Survey*".

Details of Review

In the open box section, the auditor must describe the records and procedures used to verify the reported amounts. Additionally, any assessment resulting from the examination must be explained and properly cited.

Sales Examination

This section of the narrative will specifically indicate the procedure used and discrepancies found in the examination of sales.

Description *(Select from the Drop-down box)*

Indicate the following:

- No sales tax deficiency established.

- Additional state taxable sales
- Additional Allegheny County local taxable sales
- Additional Philadelphia County local taxable sales

Note: If more than one area of deficiency in the sales examination, use separate line for each description.

Amount

Enter the amount of deficiency. If there are differences for local tax jurisdictions it can be entered on additional rows.

Reference # and Report Title

Reference must be made to the related “Sales” schedules in the Bureau’s audit application software as well as the relevant “Combined Summary” and “Tax Detail” schedules, and related exhibits.

Details of Review

In the open box section, the auditor must specifically state the type of audit conducted (*i.e., complete, modified complete, test*). The narrative must discuss the tracing of a sampling of transactions to the books of original entry to the return to verify the proper recording of all transactions. Also, explain the tracing of transactions from the books of original entry to the invoice to verify all invoices were made available for examination. In addition, the narrative must address the completeness of the taxpayer’s computer records. The method used to verify the status of the computer records must be disclosed.

If a test audit was conducted, the narrative must provide the details of the test plan. This includes the disclosure of the reason for testing, the test type, the test period selection criteria, the test periods, and the actual procedures. The test plan disclosed in the narrative must be consistent with the test information provided on the *Taxpayer’s Concurrence with Test Audit Plan* form. The information presented in the narrative and on the form must disclose the Department’s full compliance with **61 Pa Code § 8(a)**. This information must be recorded in the narrative for each separate test population.

If a modified complete audit was conducted, the narrative must specifically describe the original periods, time frame, or area initially examined on a complete basis.

The narrative must describe the records examined during the audit.

The narrative must specifically state the amount of time provided to the taxpayer to obtain exemption certificates or statements.

A general description of the assessed transactions and the basis of assessment must be provided.

The narrative must provide appropriate detail for major areas of assessment and areas contested by the taxpayer. This includes referencing the laws and regulations that support the assessment.

The narrative must describe any sales that the taxpayer was improperly charging tax and discuss the corrective actions that were recommended. Also discuss the Bureau's response if similar issues are identified during any subsequent audit.

Use Tax Phase

Use Tax Accrual

This section of the narrative must clearly state the findings of comparing the taxpayer's reported use tax to use tax accrued in the taxpayer's books.

Description *(Select from the Drop-Down Box)*

Indicate the following:

- No differences
- Unreconciled Differences
- No audit findings were established.
- State use tax deficiency
- State use tax credit
- Local use tax credit
- Local use tax deficiency

Note: If more than one area of deficiency in the use tax accrual examination, use separate line for each description.

Tax Accrual Difference

Any discrepancies or errors in the reporting of use tax must be explained, documented, and referenced in the narrative.

Reference # and Report Title

The narrative must reference the "Accrual Differences" schedule and "Accrual Error" schedule along with *Reference number* from the "Sales and Use Tax Report". The records used in the reconciliation must be the same records referenced in the System Survey.

Details of Review

In the open box section, the auditor must describe the records and procedures used to verify the reported use tax including the tracing of a sampling of transactions where the taxpayer accrued use tax to the use tax accrual account as to verify the accuracy of the reported use tax. Additionally, any assessment resulting from the examination must be explained and properly cited.

If reported amounts could not be traced to a use tax accrual account, the narrative should indicate that the reported use tax was treated as prepayment and used to offset any deficiency established in the capital and expense purchase exams.

Capital Assets

This section of the narrative will specifically indicate the procedure used and discrepancies found in the examination of the purchase of capital assets.

Description

Indicate the following:

- Additional State Taxable Purchases
- Additional Allegheny County Local Taxable Purchases
- Additional Philadelphia County Local Taxable Purchases.
- No audit findings were established.

Note: If more than one area of deficiency in the capital assets examination, use separate line for each description.

Amount

Enter the amount of deficiency. If there are differences for local tax jurisdictions it can be entered on additional rows.

Reference # and Report Title

The narrative must indicate the “*Reference Number*” of the “Capital Assets” schedules from the “Sales and Use Tax Report” as well as the relevant “Combined Summary” and “Tax Detail” schedules from “Audit Report”.

Details of Review

In the open box section, the auditor must describe the methods and records used to conduct an audit on capital purchases. This includes referencing the taxpayer’s fixed asset/depreciation schedule exhibited as part of the audit report. The completeness of the taxpayer’s fixed asset/depreciation schedule must be verified by tracing entries from the general ledger to the fixed asset/depreciation schedule. This schedule should also be reconciled to other independent sources such as the FF4562 of the federal income tax return.

The auditor must also examine fixed asset accounts such as the construction in progress (CIP) in the general ledger for any capital transactions not posted to the fixed asset/depreciation schedule. The type of records examined to verify payment of sales tax charged on the invoice must be included in the narrative. If asset purchases were found to be deficient, a general description of the expenditure and basis of assessment must be addressed in the narrative.

The narrative must state the approximate number of capital purchases made during the audit period and indicate the source.

The narrative must provide appropriate detail for major areas of assessment or areas contested by the taxpayer. This includes referencing appropriate laws and regulations and related exhibits.

For entities with a business exemption, assessed capital assets should include specific reasoning as to why the assets did not qualify for the exemption. Such reasonings include:

- Pre- and post-production
- Maintenance
- Real estate
- Safety and fire prevention
- Waste disposal
- Employee use
- Management and administration
- Space heating, cooling, and illumination

The narrative should include a few sentences that describe how the items are used.

For example:

Items used in maintenance activities included welding supplies, electronic diagnostic tools, hydraulic lifts, cleaning compounds, and truck washes. These purchases of tangible personal property were taxable according to 61 Pa. Code §§ 31.1(2), 31.7(a)(1), 32.25(b)(2), 32.32(a)(3)(ii), and 32.35(a)(3)(ii).

Certain equipment, such as forklifts, can be used directly and not directly in production. If the forklifts are not solely used in one designated area, the auditor should request an equipment study to support the direct and indirect usage within the manufacturing process in order to determine predominance.

Expenses

This section of the narrative will specifically indicate the procedure used and discrepancies found in the examination of expenses.

Description

Indicate the following:

- Additional State Taxable Purchases
- Additional Allegheny County Local Taxable Purchases
- Additional Philadelphia County Local Taxable Purchases.
- No audit findings were established

Note: If more than one area of deficiency in the expense examination, use separate line for each description.

Amount

Enter the amount of deficiency. If there are differences for local tax jurisdictions it can be entered on additional rows.

Reference # and Report Title

The narrative must indicate the “*Reference Number*” to the “Expense” schedules from “Sales and Use Tax Report” as well as the relevant “Combined Summary” and “Tax Detail” schedules from “Audit Report”.

Details of Review

The narrative must document the procedures used in verifying the completeness of the records presented for examination such as tracing a sampling of transactions from the books of original entry to the expense purchase invoices. The type of records examined to verify payment of sales tax charged on the invoice must be included in the narrative.

The narrative must state the approximate number of expense transactions per month or year and identify how the approximation was determined.

There must be a description of the type of audit performed (*i.e., test, modified complete, complete*).

If test procedures were used, then this section of the narrative must include a statement that provides the reason for conducting a test (*i.e., volume of records, record availability, etc.*). The criteria for selecting test periods must also be provided. The selected test periods and test method must be described. Reference must be made to the *Taxpayer’s Concurrence with Test Audit Plan* form as well as a “Test Period Selection” schedule, “Error Rate” schedule, and a “Projection” schedule. The information provided in the narrative must be consistent with information detailed on the test form and must reflect compliance with **61 Pa. Code § 8(a)**.

If a modified complete audit was conducted, the narrative must specifically describe the original periods, time frame, or area initially examined on a complete basis.

There must be a general description of untaxed taxable transactions assessed by the auditor and the basis for assessment.

An audit of a construction contractor must also separately address job costs from general operating expenses. Job costs differ from general operating expenses; therefore, separate examination of these expenditures is required.

The narrative must provide appropriate detail for major areas of assessment or areas contested by the taxpayer. This includes appropriate cites to laws and regulations and related exhibits.

Credits

This section of the narrative will discuss any credits granted during the audit examination.

Description

Indicate the following:

- State taxes paid purchases resold (TPPR) credit.
- State third party credit
- No credit was granted

- State use tax overpayment
- Allegheny County local taxes paid purchases resold (TPPR) credit
- Philadelphia County local taxes paid purchases resold (TPPR) credit
- Allegheny County local use tax overpayment
- Allegheny County local third-party credit
- Philadelphia County third-party credit

Note: If more than one area of credits is being granted within the audit, use separate line for each description.

Amount

Enter the amount of credit being granted.

Reference # and Report Title

The narrative must indicate the “*Reference Number*” to the different credit schedules from the “Sales and Use Tax Report”. Below outlines specific report titles for credit schedules to reference in this section.

Details of Review

Use Tax Overpayment Credits

The narrative must specifically explain use tax overpayment credits granted in the audit and reference the related “Use Tax Overpayment Credits” schedule from Bureau’s audit application software. The narrative should also explain the reason for denying any credits. All denied credits should be listed on a separate schedule. All corresponding schedules and exhibits supporting the granting or denial of the credits must be referenced in the narrative.

Third Party Credits

The narrative must specifically explain third party credits granted in the audit and reference the related “Third Party Credits” schedule from the Bureau’s audit application software. The narrative should also explain the reason for denying any credits. All denied credits should be listed on a separate schedule. All corresponding schedules and exhibits supporting the granting or denial of the credits must be referenced in the narrative including the taxpayer’s attestation letter.

Taxes Paid Purchases Resold Credits

The narrative must specifically explain taxes paid purchases resold credits granted in the audit and reference the related “TPPR Credits” schedule from the Bureau’s audit application software. The narrative should also explain the reason for denying any credits. All denied credits should be listed on a separate schedule. All corresponding schedules and exhibits supporting the granting or denial of the credits must be referenced in the narrative including the taxpayer’s attestation letter.

Pennsylvania Personal Income Tax Withheld and Paid

Employer Withholding of Pennsylvania Personal Income Tax

This section of the narrative must describe the results of comparing taxable wages and personal income tax withheld as reported to the Department via W-2 transmittal and W-3 returns to the taxpayer's records.

Account Number

List the taxpayer's Employer Withholding license number.

W-2 Transmittal Filed

Indicate the month and year when W-2 Transmittals were filed. If there were periods that were not filed, indicated in the "Areas of Discussion" section of the narrative.

PA-W3s Filed

Indicate the month and the year when the W-3 Transmittals were filed. This should be comparable to the W-2 Transmittals filed. If there were periods that were not filed, you will need to explain in the additional comments section. If there wasn't any W-3's filed than indicate none and explain in the "Areas of Discussion" section of the narrative.

Comparison of W-2s to W-3s (select from the Drop-Down Box)

Indicate the following:

- PA-W3s lower
- PA-W3s higher
- No differences noted
- Other-See areas of discussion

See Reference

The narrative must indicate the Reference Numbers and Report Title for the "EW Accrual Differences" schedule and the "Employer Withholding Reconciliation" schedule from the "Sales and Use Tax Report".

Records Examined

Indicate the payroll records that were used as part of the examination for Employer Withholding.

Examples:

- Payroll Summary
- Salary and Wage reports
- Payroll Register
- Quarterly PA-W3, etc.

Periods Examined

Indicate the periods that were examined. The auditor is required to review one quarter to determine if the proper tax was withheld. The auditor must examine the taxpayer's payroll records to ensure that all taxes withheld in each quarter were properly reported.

All Tax Withheld Reported, All Taxable Compensation Included, and Tax Withheld at Proper Rate *(Select from the Drop-Down Box)*

Indicate the following:

- Yes
- No, See Areas of discussion.

Areas of Discussion

The auditor must discuss any areas of discrepancies regarding the Employee Withholding review.

When the taxpayer has remitted all taxes due but has non-filed returns, the narrative must indicate that the taxpayer was instructed to file the missing returns through [myPATH](#).

If the initial exam of these records results in a collateral audit, then the resulting audit assignment must be referenced.

Personal Income Tax

For sole proprietors, partnerships, and subchapter "S" corporations, the narrative must describe the taxpayer's compliance with Pennsylvania Personal Income Tax requirements. The narrative must state that the business income was reviewed, and that the entity properly reported the income to the principles on a RK-1 or NRK-1 form. If an entity's income tax return was not filed with the Department, state the year or years not filed.

Post-Audit Conference

The purpose of this section of the narrative is to document the information presented to the taxpayer by the auditor at the conclusion of the audit. This section of the narrative must specifically address the following areas:

Conference Information

The date, place, and length of the post audit conference must be documented. If the conference is conducted by telephone, the time of day must also be specifically indicated in the narrative. The follow up [Post Audit Conference by Phone Letter](#) must also be referenced in this section.

Note: A signed “Post Audit Conference letter is not required if the auditor receives a signed electronic image of the *Taxpayer’s Acknowledgement of Post Audit Conference* form prior to post audit conference or immediately after.

Taxpayer’s and Department’s Representative(s)

The names and titles of attendees must be listed in this section of the narrative.

Taxpayer’s Acknowledgement of Post-Audit Conference

The total deficiency must be stated in this section of the narrative. The auditor will also indicate the appropriate response from the drop-down box for the following:

Representative(s) notified of appeal rights and procedures. (Yes or No)

- The taxpayer must be informed that the statute of limitations for all credits related to the audit period is six months from the date on the notice of assessment or three years from the payment of tax, which is later.

Representative Agreement with audit findings:

- *Agrees*
- *Disagrees*
- *Disagrees in part*
- *No indication*

Taxpayer intends to appeal findings:

- *Yes*
- *No*
- *Unsure*

Representative signed form:

- *Yes*
- *No*
- *Declined*
- *Form not returned*

Record Removal Receipt (records returned):

If hardcopy (paper) records were removed from the taxpayer’s site, the auditor must provide a *Record Removal Receipt* form located in the Bureau’s audit application software of a list of records removed where both the auditor and the taxpayer will sign and date. Once the records are returned, the taxpayer and the auditor will sign and date the form. The audit assessment will not be issued until all source records are returned to the taxpayer.

Post-Audit Conference letter

If a [Post Audit Conference by Phone Letter](#) was issued, the auditor will indicate the exhibit.

Audit Recommendations

The auditor can use this area of the narrative to discuss recommendations that were made to the taxpayer and/or representative(s) during the post-audit conference.

Explain Areas of Disagreement

Areas of disagreement must be addressed in this section of the narrative. Taxpayer arguments against the audit findings should be discussed. In addition, the basis for assessment on any disputed items should be restated.

Areas of Discussion

This section can be used to discuss other issues that were noted during the post-audit conference:

Penalty Abatement

This section of the narrative must address any abatement of penalty granted through the audit. The following language is recommended:

“The Taxpayer was advised the auditor was recommending penalty abatement and provided a “Penalty Abatement Petition Form”, the Taxpayer was further advised that completion of a petition for penalty abatement did not preclude the Taxpayer from petition the Board of Appeals for reassessment based on disagreements with the tax liability as established through audit.”

Interest and Penalty

The narrative must disclose that the Department’s policy on interest and penalty as it relates to the assessment was explained to the taxpayer.

Sales and Use Report

The audit findings are documented through the “Sales and Use Report” generated by Bureau’s audit application software. The “Sales and Use Report” includes all the reports necessary to support the basis for assessment.

Tax Codes and Rate Categories

The Bureau’s audit application software uses several tax codes and rate categories to classify audit adjustments by tax type and category.

Tax Codes

Tax codes are used to identify the rate that the Bureau audit application software imposes on a transaction. Audit findings must be listed under the proper tax code to segregate the findings properly. These tax codes are included in the audit report generated by the Bureau's audit application software in alphabetical order. The tax codes used in the Bureau's audit application software include the following:

Title	Tax Code
State Sales Tax	S00
Allegheny Sales Tax	S02
Philadelphia Sales Tax	S51
State Use Tax	U00
Allegheny Use Tax	U02
Philadelphia Use Tax	U51
Consumer Fireworks Tax	CFT
E-911	E911
State Hotel Occupancy Tax	H00
Allegheny Hotel Occupancy Tax	H02
Philadelphia Hotel Occupancy Tax	H51
Public Transportation Lease Tax	PLEAS
Public Transportation Rental	PRENT
Public Transportation Tire	PTIRE
Vehicle Rental Tax	VRENT
Employer Withholding	EW

Figure 7.1 Bureau's Audit Application Tax Code

Rate Categories

Rate categories are primarily used to identify and segregate credits granted in the audit. Deficiencies found in the audit are always assigned a “General Deficiency” rate category. Credits granted in the audit use a rate category determined by the type of credit granted. The Bureau’s audit application software uses the following rate categories:

Title	Rate Category
Third-Party Credit	[3]
Accrual Error	[A]
General Deficiency	[G]
Taxes Paid, Purchases Resold Credit	[T]
Use Tax Over-payment Credit	[U]

Figure 7.2 Bureau’s Audit Application Software Rate Category

Reports

The Bureau’s audit application software has a number of reports available to include in the “*report stack*”. The report stack is created using the “Report Generator” that is available in the “Tools” menu or by the F9 hotkey. The report titles contained in the “Table of Contents” are arranged in outline format using indentations to show how the various reports relate to each other as to their dependencies one to another. Individual report totals are traceable from report to report, up and down the table of contents’ outline format. The left-most indented report titles contain the highest level of summary information while the right-most indented report titles contain the highest level of transactional detail. Annotations within the transactional reports documents the basis for assessment. The reports that must be included in the “Sales and Use Report” are dependent on whether there are audit findings or not.

Reports always Included

When running the Report Generator, the following reports must be selected under Reports to Print for **all** audits (including “none” audits):

- Table of Contents
- Billing Summary
- Filing Detail
- Raw Schedules

Reports to Include for Findings

For audits with findings (net deficiency or net credit audits), the following reports must also be selected under Reports to Print:

- Billing Sheet
- Tax Detail
- Combined Summary
- Formatted Schedule
- Distribution

Report Descriptions

Distribution Report

Although this is not the highest-level summary report, it will appear as the first report in the “Sales and Use Report”. This report will provide a summary of the assessment by Tax Code and Tax Category showing the total tax for the entire audit period. This report is informational only within Bureau’s audit application software and is not related to any revenue accounting.

Billing Summary

The *Billing Summary* recaps the net assessment by *Tax Code*, showing the total tax due for the audit period. This report calculates down to the locality level.

Billing Sheet

This schedule provides a summary of the net assessment by filing period. This report will repeat for each *Tax Code* listed on the *Billing Summary* report.

This schedule will be formatted one of two ways. If the assessment does not include accrual errors or stratified random samples, the *Billing Sheet* will list the net tax due by filing period. If the assessment includes accrual errors or stratified random samples, the *Billing Sheet* will separate the net tax due from the accrual errors or stratified random samples under the “Tax Adj” column of the *Billing Sheet*. The *Billing Sheet* contains the following:

Period

Ending dates for monthly, quarterly, or semiannual reporting period.

Tax

The total net tax due of all Rate Categories.

Tax Adj

Net tax adjustments from accrual errors or stratified random samples.

Tax Detail

This schedule provides a summary of the assessment by filing period for each *Tax Category*. This report will repeat for each *Tax Code* listed on the *Billing Summary* report. This schedule lists the tax measure, tax rate and calculated tax or credit for each *Tax Category*.

Period

Ending dates for monthly, quarterly, or semiannual reporting period.

Measure

The total tax basis of all "Rate Categories".

Rate

Applicable tax rate.

Tax

Measure multiplied by rate.

Tax Adj Detail

This schedule provides a summary of the assessment by filing period for each *Tax Category* with a tax adjustment. This report will repeat for each *Tax Code* with an adjustment to tax.

Combined Summary

This schedule provides a summary of the tax measure by filing period for each *Tax Category*. This report will repeat for each *Tax Code & Tax Category* listed on the *Distribution Report*.

Period

Ending dates for monthly, quarterly, or semiannual reporting period

Measure

The total tax basis of all Rate Categories.

Tax Adj by Source

This schedule provides a summary of the tax adjustment by filing period for each *Tax Category*. This report will repeat for each *Tax Code and Tax Category* with an adjustment to tax.

Schedules

Schedules are created by auditors to detail the transactions assessed during the audit. Separate schedules are generated for each *Tax Code* and *Tax Category*.

The Report Generator in Bureau’s audit application software has a section listing all the schedules that have been created in the audit folder. There are three options for printing schedules in the report stack. The options are “*Calculate and Print*”, “*Print Only*”, and do not print (unchecked). Schedules that are selected to “*Calculate and Print*” will be used in the calculation of the audit assessment. These schedules are included in the *report stack* as a formatted schedule, where the schedule is subtotaled by reporting period. When printed as a formatted schedule, any schedule that contains multiple *tax codes* or *rate categories* will also be segregated by those *tax codes* and *rate categories*. Formatted schedules are included in the *report stack* in the hierarchy of reports discussed above. Schedules that are selected to “*Print Only*” are not used in calculation of the audit assessment. These schedules are included in the *report stack* as a *raw schedule*. *Raw schedules* are included in the *report stack* with the same formatting and order as they appear on the working schedule in the Bureau’s audit application software. *Raw schedules* are included in the *report stack* in a “*Supporting Exhibits*” section at the end of the *report stack*.

The order of the schedules that are presented in the report will depend on whether they are formatted or *raw* schedules. Formatted schedules will be presented in alphabetical order under the corresponding *Combined Summary* or *Tax Adjustment by Source* report by default. *Raw* schedules will be presented in alphabetical order under the *Other Exhibits* section. The order the schedules are presented under their corresponding report can be adjusted by selecting a schedule and moving them in lists of schedules using the up and down blue arrows found at the bottom of the *Schedule* section.

Schedule Descriptions

Template Schedules

Standardized templates schedules are maintained in the Bureau’s audit application software for common transactions encountered during an audit. When audits are submitted for processing, transactions must be entered in a template schedule or in a schedule that contains the same columns in the same order. The amounts from these schedules “roll-up” to the summary reports listed above.

The template schedules include the following columns:

Invoice Date

The date listed on the sales or payable invoice.

Reason Code

Numerical value linked to the Reason Description table.

Reason Description

A table of standardized reason descriptions used to provide a basis for assessment (i.e., Missing Exemption Certificate, Indirect Use).

Invoice Number

The number listed on the sales or payable invoice.

Customer/Vendor

The name of the customer on the sales invoice or the name of the vendor on the payable invoice.

Description

A brief description of the property purchased or sold that was subject to tax.

Invoice Amount

The total amount of the invoice including any taxable or nontaxable amounts.

Invoice Taxable Amount

The taxable portion of the Invoice Amount.

Tax Charged

The amount of any sales tax charged on the invoice or the amount of use tax accrued and reported.

Tax Rate

The rate of the sales tax charged on the invoice or use tax accrued.

Additional Taxable Amount

This is a calculated field and represents the measure amount listed on the *Combined Summary Schedule*. Any sales tax charged or use tax accrued is divided by the *Tax Rate* and then subtracted from *Invoice Taxable Amount* to arrive at the *Additional Taxable Amount*.

State Exempt

This check box is used if the transaction is exempt from sales tax (i.e., state sales tax was charged on the invoice), but subject to a local sales/use tax.

Alleg/Phila Co

These check boxes are used if the transaction is subject to Allegheny County or Philadelphia County local sales/use tax.

Filing Detail

The Filing Detail report summarizes the filing frequency of the taxpayer. This report displays the ending dates of the filing periods, due dates, filing date, any discounts by taxing jurisdiction, and any credits by taxing jurisdiction.

Period Ending

Ending dates for monthly, quarterly, or semiannual filing period.

Due Date

The date the return was due.

Date Filed

The date the return was filed.

Payment Date

This field is not normally populated.

Under-statement

Check box indicates understatement penalties imposed.

Major Under statement

Check box indicates major penalties imposed.

Not Filed

0 = return filed, 1 = non-filed return.

Working Paper

Identification number for location of the document data.

Period Key

Identifies the period the return was filed. The period key consists of a four-digit number where the first two digits identify the year and the last two identify filing period (01-12 = monthly; 41-

44 = quarterly; & 21-22 = semiannual).

AST Penalty

Indicates any accelerated sales tax penalty for failure to file or underpay accelerated sales tax.

TPPR Credit

Check box indicates Taxes Paid Purchases Resold credit taken on return. Auditor must verify these credits.

Late Penalty

Indicates if any late penalties were charged.

PA Discount

Amount of discount taken on the return for state sales tax.

AL Discount

Amount of discount taken on the return for Allegheny County sales tax.

PH Discount

Amount of discount taken on the return for Philadelphia County sales tax.

E911 discount

Amount of discount taken on the return related to E911 fees.

PA Credit

Amount of state tax credit taken on the return. Auditor must verify credit.

AL Credit

Amount of Allegheny County credit taken on the return. Auditor must verify credit.

PH Credit

Amount of Philadelphia County credit taken on the return. Auditor must verify credit.

Accrual Differences

The “Accrual Differences” schedule must be included in the Sales and Use Report. The purpose of the schedule is to document the comparison of sales information recorded in the taxpayer’s books to the information reported to the Department on the Sales and Use Tax Return. The auditor manually enters the numbers from the taxpayer’s books when the numbers are different from those reported on the tax return. Differences are calculated by the audit application.

Period

Ending dates for monthly, quarterly, or semiannual filing period.

Jurisdiction

This field designates the taxing jurisdiction based on the Tax Codes.

Reported Gross Sales

Gross sales as reported by the taxpayer on the sales and use tax return for the filing period and Tax Code.

Audited Gross Sales

Gross sales as verified and/or determined by the auditor.

Gross Sales Difference

This represents the difference between gross sales in the taxpayer’s records and the gross sales reported on the sales and use tax return for the same filing period and Tax Code.

Reported Taxable Sales

Taxable sales reported by the taxpayer on the Sales and Use Tax return for the same filing period and Tax Code.

Audited Taxable Sales

Taxable sales as verified and/or determined by the auditor.

Taxable Sales Difference

This represents the difference between taxable sales in the taxpayer’s records and taxable sales reported on the Sales and Use Tax Return for the same filing period and Tax Code.

Reported Tax Accrual

Tax as reported by the taxpayer on the Sales and Use Tax Return for the filing period and Tax Code.

Audited Tax Accrual

Tax as verified and/or determined by the auditor.

Tax Accrual Difference

This represents the difference between tax accrued in the taxpayer's books and records, and the tax as reported on the sales and use tax return for the same filing period and Tax Code. This difference becomes a tax deficiency or a credit.

Reported Taxable to Gross %

Reported Taxable Sales divided by Reported Gross Sales. This column is not printed on the schedule in the Sales and Use Report.

Reported Effective Rate

Reported Tax Accrual divided by Reported Taxable Sales. This column is not printed on the schedule in the Sales and Use Report.

Major Penalty

The box is checked to apply major penalties. This column is not printed on the schedule in the Sales and Use Report.

Major Penalty Amount

This field lists the amount of the major penalty. The audit application is programmed to calculate the amount of the major penalty.

Test Schedules

The *Block Sample* and *Stratified Random Sample (SRS) Wizards* generate a number of schedules that are used to calculate error rates and projections, the *SRS Wizard* also creates a number of schedules to apportion the deficiency to the proper period, tax codes, and rate categories. Audit reports that include testing procedures must also include the following schedules:

Schedules - Block Sample

Block Projection Error Rates

This schedule details the calculation of the error rate by *Tax Code* and *Tax Category* (**Print Only**).

Block Sample Population Summary

This schedule lists the population amounts by filing period and the test periods within the population (**Print Only**).

Block Sample Projection

This schedule calculates the additional taxable measure by filing period for each *Tax Code* and *Tax Category* (**Calculate and Print**).

Outliers

Any transactions that were suspected outliers and removed from the test projection (**Calculate and Print**).

Schedules - SRS

SRS Sample Errors

This schedule details only those transactions from the sample with tax errors (deficient and/or credits).

SRS Estimates

This schedule projects the total net tax due from the sampled transactions. Except for the complete stratum, the total net tax due tax from each stratum is projected against the frame total resulting in the total net tax due for the population.

SRS Allocation (Jurisdiction/Strata)

These schedules allocate the total net tax due by *Tax Code* and *Tax Category*. Both are informational schedules with the same data but sorted by jurisdiction and stratum.

SRS Precision

This schedule calculates the precision at a 90% confidence level.

SRS Projection

This schedule allocates the total net tax due by *Tax Code* and *Tax Category* for each filing period in the population.

SLSWKS Template

Excel worksheets templates are available under attachments in the Bureau's audit application software. These templates include:

Audit Status Report Worksheet and Audit Plan

Refer to chapter 8-[Audit Plan and Audit Status Worksheet](#) for further information on when to use this template.

Gross Sales Analysis

To be used to analyze the taxpayer's gross sales by comparing the sales and use tax returns, taxpayer's sales summary and detail records and audited gross sales to the taxpayers' gross sales reported on tax returns and/or financial statements. This spreadsheet is used to verify the completeness of sales used in the sales examination.

Sales Tax Accrual Analysis

To be used to analyze the taxpayer's reported sales tax on the sales and use tax return and in general ledger account to the audited sales tax. This spreadsheet is used to verify all sales tax collected and self-assessed use tax was properly reported to the Department.

Test for Sales *(Full, Partial and One Year)*

The methods for selecting the test periods must be explained including a schedule detailing how the test periods are selected. This template will be used in provide detail of the selected test periods based on the taxpayer's gross sales and sales tax reported to calculate a taxable to gross sales ratio. The periods are selected then based on the most representative period(s) in the audit.

Asset Reconciliation

This schedule is used to reconcile the taxpayer's capital purchases for completeness and identify any undocumented Pennsylvania asset acquisitions and/or dispositions during the audit period.

Test for Expenses

The methods for selecting the test periods must be explained including a schedule detailing how the test periods are selected. This template will be used in provide detail of the selected test periods based on the taxpayer's expenses on selected general ledger accounts to select the most representative period(s) in the audit.

These templates are not required to be used, but schedules supporting the procedures performed during the audit must be completed and included in the audit report.

Audit Workpapers

Audit workpapers are generally created through standardized templates in the Bureau's audit application software. Auditors are permitted, and in some cases required, to create workpapers (i.e., Excel) outside of the standard templates. These customized workpapers may calculate a tax deficiency or credit or provide supplemental information to support the schedules in the Bureau's audit application software. Any other schedules calculating a tax deficiency or credit must be imported into the Bureau's audit application software. In addition, the Excel file should be saved in the audit folder under "Attachments".

Schedules must be prepared in accordance with the Bureau's standard format described below:

- Each page of each schedule must be properly headed.
 - Headings must include:
 - Audit ID
 - Taxpayer's legal Name
 - Federal Employer Identification Number (FEIN) or Social Security Number (SSN)
 - Account ID
 - Beginning Audit Period
 - Ending Audit Period
 - Auditor's Name
 - Audit Supervisors Name
 - Schedule name
 - Schedule number
- Workpapers must be paginated using the Page X of Y format (e.g., Page 1 of 2).
- Workpapers must reference any supporting documentation.
- Footnotes should be included to provide necessary explanations.
- Workpapers must be footed and cross-footed to prove mathematical accuracy.
- Workpapers must be professional in appearance.

Exhibits

Generally, exhibits are documents supplied by the taxpayer and are included in the audit report to substantiate the audit findings. Exhibits may also consist of written correspondence between the Department and the taxpayer. All exhibits must be referenced in the narrative. There must be continuity among the exhibits. The use of exhibits is encouraged so the auditor may provide a well-documented and comprehensive basis for the assessment.

Required Exhibits

The following documents/reports are required to be included in every audit report:

Audit Engagement Letter

Written correspondence

- Cover letters for waivers
- Confirmation letters
- Post audit conference letters, etc.

Taxpayer's fixed asset/depreciations schedule

If voluminous, the first and last page should be exhibited. A complete copy of the report must be saved to the TaxMaster audit folder.

A copy of any document or report referenced in the System Survey

If voluminous, the first and last page or any page supporting an audit finding should be exhibited. A complete copy of the report must be saved to the TaxMaster audit folder.

A listing of PA locations

Describe the activities performed at those locations. Must be include in the audit report when the taxpayer has more than one location.

Any "Order to Appear" Letter

Must be included in the report when used during the course of an audit.

Suggested Exhibits

Other documents suggested to be included in the audit report are:

- **Brochures provided by the taxpayer**
- **Photographs**
- **Copy of PUC rights**
- **Merger Agreements**
- **Organizations Charts**
- **Name Change Documentation**
- **Sales agreements**
- **Disallowed Exemption Certificates**
- **Management Agreements**
- **Contracts**

Forms

The conduct of a sales, use, and hotel occupancy tax compliance audit involves several types of forms. These include forms that are specifically designed for use in conducting an audit as

well as forms used by the taxpayer that must be examined as part of an audit. The auditor must be familiar with each of these forms. Most forms presented during the audit are created using form templates in Bureau's audit application software. The templates use tokens which pull information from the **"Taxpayer Information"** section of Bureau's audit application software.

Taxpayer Information

Taxpayer Information is accessed in Bureau's audit application software directly after creating an assignment folder or by clicking on the assignment folder. Taxpayer Information for sales and use tax audit will contain two tabs named *"General"* and *"Sales and Use"*. The data to be entered and information concerning where it can be located is listed below:

General Tab

PATH ID

10-digit PATH number.

FEIN/SSN

9-digit Federal employer identification number or social security number for sole proprietorship or single member LLC with no FEIN.

ACCOUNT ID

PATH provides each converted or native account with an 11-digit account ID number.

Audit ID

The audit is assigned in PATH an identification number which includes "A" and 4 digits.

Legal Name

This is the taxpayer's legal name and is the same as the legal name listed in PATH in the Customer Springboard under the "Registration:" tab and "Names" subtab and/or the *Bureau of Audits-Registration Verification* form line 1. It should also be verified to the Department of State's website.

Notes:

- If there is a discrepancy in the legal name listed on the *Bureau of Audits Registration Verification* form, PATH and Department of State's website, the auditor should address with the taxpayer for verification and use the information provided on the *Bureau of Audits Registration Verification* form. Any discrepancies should be discussed in the narrative.
- Sole proprietorships should be listed as last name, first name, middle initial.

Trade/DBA Name

This is the taxpayer's trade name and is in PATH in the Customer Springboard under the "Registration" tab and "Names" subtab and/or line 3 of the *Bureau of Audits-Registration Verification* form. The legal name and trade name may be the same.

Business Address

This is generally considered to be the taxpayer's "headquarters" address. It is the same address listed as the physical street address shown in PATH in the Customer Springboard under the "Registration:" tab and "Addresses" subtab, or line 5 of the *Bureau of Audits-Registration Verification* form.

Note: Business address **cannot** be a P.O. Box.

Assessment Mailing Address

This is the address to where the assessment is mailed. It is generally the same as the mailing address listed in PATH in the Customer Springboard under the "Registration:" tab and "Addresses" subtab. It is also generally the same mailing address as listed on line 6 of the *Bureau of Audits-Registration Verification* form.

NOTE: When a taxpayer requests the assessment be sent to an address that is different from the taxpayer's business or mailing address (e.g., accountant's address), the Additional Headquarters Processing (1105) form must be prepared notifying HQ to mail a copy of assessment to the second address listed on the 1105.

Date to Supervisor

Date the audit was submitted to supervisor for review.

Pa Locations

The number of Pennsylvania locations. If taxpayer has more than one PA location, an exhibit of the Pennsylvania locations with the addresses must be included in the audit report.

Main Contact Person, Title, and Telephone Number/Additional T/P Representative's, Title, and Telephone Number

This section is used to list the taxpayer and/or their representatives that assisted in the conduct of the audit by attending the audit conferences, providing the records during the course of the audit, or conducting tours.

Bankruptcy Type, Date Filed, Cause Number, Bar Date, and Court Filed

This information is typically found on the website of the bankruptcy court and in PATH under the "Registration" tab and "Bankruptcies" subtab.

Case Totals

The information is populated whenever the Report Generator is run and shows the current audit totals.

Sales And Use Tab

Tax Type

Sales and Use.

Control Number

Audit Assignment Number SLSAXXXX

License ID

Sales tax account number.

Waiver Tax Type

Sales and Use.

Waiver From Date & Waiver to Date

Beginning & ending date of the waived periods.

Waiver Expiration Date

The waiver expiration data should match the date in PATH.

Trade/DBA Name

Automatically populates with Trade/DBA Name entered on the General tab.

Beginning Period & Ending Period

The beginning and ending dates of the audit period.

Reporting Interval

SUT Account filer frequency (Monthly, Quarterly, or Semi-Annually).

Location Address

Address where the records are located.

Type of Ownership

Select type of organization from the drop-down box.

NAICS Code

This is a numeric code identifying the taxpayer's line of business. It must be consistent with information presented in PATH under the "Registration" tab and "Activity Codes" subtab or line 8 of the *Bureau of Audits-Registration Verification* form.

Type of Business

Based on the NAICS Code entered, the field may automatically populate.

Pre-Audit & Post Audit Dates

The dates in this section must match the dates in PATH under the "Audit" springboard, "Attributes" tab.

Auditor's Name

The name of the auditor(s) that conducted the audit should be included in this section along with the number of hours charged to the assignment and production percentage. The hours charged to an assignment must reconcile to the hours listed in PATH.

Supervisor Name

The name of supervisor responsible for reviewing the audit.

Additional Headquarter Processing Request

Check the box if an *Additional Headquarters Processing Request* form is included with the audit.

IRS Disclosure Limitations

This form is required in every audit that contains Federal Tax Information (FTI). It must be the first document of the audit package. In addition, the Audit folder name and assignment number should be renamed to include the "_FTI" suffix.

Audit Package Checklist (Index)

Each audit report must contain an index. The index provides a list of all forms, schedules, Sales and Use Tax reports and exhibits included in the audit report. Each document included in the audit report must be referenced on the Index along with the corresponding number of

pages. The Index also indicates which documents are included in the copy of the audit report mailed to the taxpayer.

The first section of the index lists audit forms. The second section of the index lists SUT report. The next section lists the supplemental schedules, and the last section lists the exhibits.

Audit Report and Basis of Assessment

This form is the cover sheet for every audit report. It provides summary information on the report.

“Taxpayer Information”

The following fields are populated from the data entered on the “Taxpayer Information” screen from the Bureau’s audit application software:

- Header Information-Located at top right corner.
- Legal Name
- Trading/As Name (T/A Name)
- Assessment Mailing Address
- Business Address
- Address Where Records Located
- Number of PA Business Locations
 - If there is more than one PA Business Location, an exhibit of all PA locations must be included in the audit.
- Type of Ownership
- NAICS Code
- Bankruptcy Information
- Waiver Information
- Taxpayer Representative

Principals (Owners/Officers)

The individuals listed in this section are the same as the individuals listed on line 15 on the *Bureau of Audits-Registration Verification* form or in PATH under the “Registration” tab and “Responsible Party” subtab. This field is manually entered. If the owner is a corporation, limited liability company, or partnership, list their EIN. For individual owners/officers **DO NOT** list social security numbers in the EIN field.

Total Tax Amount to be Assessed

This field is automatically populated based on the most recent Sales and Use Report. If the Sales and Use Report is run after the form is created, the tokens must be refreshed (*click on Reveal Tokens & Save to refresh the data*) to update the “Total Tax Amount to be Assessed”.

Conflict of Interest and Auditor's Comments

This form is confidential and is intended for Department use only. It is to be included in the Dept. Documents. The form must be signed by everyone charging time on the audit. It is not to be included in the copy of the audit report mailed to the taxpayer.

The auditor may use this form to disclose information relating to the audit that is not disclosed elsewhere in the audit report. This information may include auditor observations that provide additional insight into the audit findings. The auditor may also reference on this form Board of Appeal decisions, letter rulings, Department policy, etc., that support the audit findings. This form may also be used to explain large differences between current and prior audit findings.

This form must also be used by supervisors to document that credits greater than \$5,000 granted by the auditor have been reviewed and approved by the supervisor. Test period exceptions must also be acknowledged by the supervisor on this form.

Taxpayer's Acknowledgement of Post Audit Conference

This form is required to be in every audit report. It is used to secure the taxpayer's written acknowledgement that the audit findings were discussed with the taxpayer at the conclusion of the audit and prior to the issuance of any assessment. It acknowledges that the auditor explained the procedures for assessment, additions of interest and penalty, and appeal procedures. This form is also used to record the auditor's corrective recommendations. This form is used for every type of post audit conference including face-to-face meetings and conferences conducted by phone. This form should also be sent to the taxpayer when a post audit conference is not held due to a lack of cooperation from the taxpayer (*post by mail*). The form is then presented to the taxpayer for signature. When a post-audit conference is conducted by phone or one cannot be held, the auditor should follow the procedures discussed in [Chapter 6](#) relating to post-audit conference by phone and inability to schedule post-audit conference.

Completion of the Form

Completion of the form is discussed below.

Audit Period

This period must be the same as the period referenced throughout the audit report. This field is automatically populated from the data entered in the "Taxpayer Information" screen.

Audit Deficiency

This is the total tax deficiency established by audit. It does not include penalty and interest that will be posted as part of the official assessment. This field is automatically populated from the data entered in the "Taxpayer Information" screen. It must equal the total amount listed on the "*Distribution Report*" included in the Sales and Use Report as well as the amount documented in the post audit conference section of the narrative.

Name of Auditor

The name of the auditor conducting the conference must be listed in this block. This field is automatically populated from the data entered in the “Taxpayer Information” screen.

Areas of Deficiency

This section of the form must itemize the amount due by area of deficiency and reference the supporting schedules within the Sales and Use Report.

Recommendations To Taxpayer for Correcting Areas of Deficiency

This section of the form must always be completed. It must provide recommendations to the taxpayer for correcting the areas of deficiencies identified in the audit.

Name and Signature of Taxpayer or Authorized Representative

The taxpayer or the taxpayer’s representative must be asked to sign the form. The term “taxpayer’s representative” includes employees of the taxpayer who represented the taxpayer during the audit. As part of providing the signature, the taxpayer may also indicate agreement or disagreement with the findings. The taxpayer may also provide additional comments. If the taxpayer declines to sign the form, the auditor must note the time, date, reasons, and the person involved on the form.

Request for Financial Records

This form must be used and included in the audit report for every instance when the records requested are not furnished. This document provides a record of the auditor’s specific request for, and the taxpayer’s written explanation for failure to provide, records needed to conduct the audit. Proper use of this form will eliminate any misunderstanding concerning record requests. It also provides documentation supporting the use of alternative audit procedures due to the lack of records. More than one form may be required during the course of an audit.

Attachments or schedules referenced on this form must be included in the audit report as attachments to the records request. Items attached to the form should be an exact copy of the schedule or attachment referenced.

This form is also used to document that a reasonable amount of time was afforded to the taxpayer to provide the requested records prior to creating an assessment due to missing or inadequate records. The auditor must sign the *Request for Financial Records* form and include a date on the form by which the records must be presented by the taxpayer.

A signature should be obtained from the taxpayer acknowledging receipt of the request. This form maybe provided to the taxpayer via email. It is recommended the auditor request the taxpayer return an electronically signed copy of the form acknowledging receipt of the request or **secure a read receipt**.

If the taxpayer is unable to make certain records available, the taxpayer should document the reason(s) for the records being unavailable and sign the form. If the taxpayer declines to complete the form, the auditor should indicate that the requested documentation was not provided, and the taxpayer declined to complete the form. The auditor should include the name of the representative the form was provided to and the date it was provided.

The auditor should follow the procedures for Requesting Records from Taxpayer in Chapter 8 of this manual.

Taxpayer's Concurrence with Test Audit Plan

This form is required to be included in every report where test procedures were used to develop a tax deficiency. It is designed to secure written acknowledgement that the auditor discussed the activities of the business with the taxpayer in order to arrive at a representative period(s) for testing. The taxpayer also acknowledges that the procedures to be used in performing the test audit(s) and the projection of any deficiency resulting from the test period(s) was thoroughly explained. Finally, the taxpayer has the option to comment on the selection of the test period(s) and results of the test projection and state any reasons for nonconcurrence.

The information on this form must accurately describe the testing process and must be consistent with information presented in the narrative. It must also accurately reflect the explanation provided by the auditor to the taxpayer.

NOTE: This form must be presented to the taxpayer for acknowledgement and signature prior to performing the test examination.

Completion of the Form

Completion of the form is performed through Bureau's audit application software. A separate form is required for each test population.

Auditor's Name

The name of the auditor who discussed the testing process with the taxpayer must be listed under the *CONCURRENCE* section of the form. The name of the lead auditor entered in the "Taxpayer Information" screen is automatically populated under the *CONCURRENCE* section of the form.

Audit Period

The audit period must be accurately stated. The audit period entered in the "Taxpayer Information" screen automatically populates this field.

Type of Test

This field must identify the type of test being performed. Types of tests normally utilized by the Bureau include block sample projectable average and stratified random sampling (SRS).

Test Objective

The test objective must indicate that the taxpayer's records are being audited to determine the taxpayer's compliance with the tax laws. For example, *"Verify sales tax was charged, collected, and reported on all taxable transactions and a valid exemption certificate was on file for any untaxed transactions"*.

Population to Be Tested

This is the population used to select the test period(s). Examples of possible test populations include gross sales and general expenses. The test population must be specifically defined. For instance, if a test is limited to a specific group of accounts, these accounts must be identified on the form or through an attachment to the form.

Test Periods

Each test period must be specifically identified. This section of the form must also indicate what time frames of the test population the specific test periods represent.

Basis for Selecting Test Period(s)

This part of the form must identify the criteria used to select the test periods. Examples of testing criteria include average gross sales, average taxable to gross sales ratio, average expenses, etc. All schedules used in the selection of the test period(s) must be referenced on this form. In addition, this part of the form must reference related *Requests for Financial Records* when the selection of the test periods is based on the lack of available records.

Test Procedure

This portion of the form must identify the transactions to be examined for the test periods, calculation of the error rate, and test projection methods. This section of the form must also indicate that the additional taxable sales or expenses identified and projected as a result of the test shall be multiplied by the applicable tax rate to calculate the tax deficiency.

Taxpayer Comments

This field is to be completed by the taxpayer. In this area of the form, the taxpayer may state any areas of concern regarding the procedures to be employed or the representation of the test periods selected from the populations.

Signatures

The taxpayer and the auditor who explained the procedures to the taxpayer must sign this form. If the taxpayer declines to sign the form, the auditor must note on the form whom the form was presented to, the date, time, and the fact that the taxpayer declined to sign the form.

The form must be included with the audit report. This information along with any other pertinent facts must also be noted in the narrative.

Taxpayer's Acknowledgement of Precision Level-Stratified Random Sample

This form is required for all audits when a stratified random sample test is conducted regardless of the precision level. Auditors should refer to [Chapter 5. Taxpayer's Acknowledgement of Precision Level – Stratified Random Sample](#), to determine how to proceed based on the taxpayer's response on the form.

Completions of the Form

Reviewing Taxpayer's Representative

Name of representative that reviewed the SRS.

Precision Level %:

The precision calculated by SRS wizard.

Stratified Random Sample

Define the sample (e.g., sales, expenses, etc.). If more than one SRS is being performed be specific in defining the sample.

Check boxes

- ☐ I accept the precision as indicated and do not request an increase in sample size.
- ☐ I do not accept the precision as indicated and request an increase in the sample size.

Consent to Extend Time Limit for Assessment/Determination of Tax and to Extend Period of Time for Record Retention (Waiver)

Issuance of Waivers

This form is used to extend the time limit for record retention and assessment of tax. It becomes a binding legal document when properly completed. When collateral audits are performed on different types of taxes, a separate waiver is required for each type of tax.

The Revenue Regional Manager is ultimately responsible for obtaining the waiver and ensuring that periods are not lost due to the expiration of the statute.

Refer to [Chapter 8](#) for further information on Issuance of Waivers.

Completion of Form

The form automatically populates Part 1 - Taxpayer Identification, Part II - Tax and Identification Numbers, Part 3 - Tax Period, and Part IV - Extended Assessment/Determination and Record Retention Dates based on data entered on the Taxpayer Information screen in Bureau's audit application software. Part V – The Consent is automatically populated with the date the form is created.

Part I: Taxpayer Identification

This section of the form must list the taxpayer's correct legal name and mailing address. This information should be verified with the legal name listed on PATH in Account Springboard "Registration" tab and/or *Bureau of Audits-Registration Verification* form as well as the Department of State's website.

Part II: Tax and Identification Numbers

This part of the form must indicate the type of tax, the related account number, and the entity's FEIN.

Part III: Tax Period

This part of the form must indicate the entire period being extended. For instance, if the period to be extended is 2019 then the beginning date must be listed as 1-1-2019 and the end date should be listed as 12-31-2019. If the extended period includes more than one year, the entire extended period must be reflected in the beginning and ending dates.

For instance, if a waiver has already been executed for 2018 and an additional waiver is needed for 2019, the beginning dates on the new form should be 1-1-2018 and the ending date should be 12-31-2019. An extension of an existing waiver must be executed on or before the date set forth in PART IV of the existing waiver. When more than one waiver covers the same period of time, all such forms should be retained by the regional manager.

Part IV: Extended Assessment/Determination and Record Retention Date

This part of the form represents the date by which an assessment for the waived periods must be issued. The postmark date on the assessment must be on or before this date. An assessment postmarked after this date prohibits the Department from assessing taxes for the waived period.

Part V: The Consent

This part explains the consent being executed by the taxpayer. The date listed in this part represents when the waiver was presented to the taxpayer for a signature. This date is the same date that the taxpayer signs the form. This part must be completed in order for the form

to be valid. If the taxpayer returns the form without completing this block, then the Regional Manager may insert the date of the taxpayer's signature as listed on the taxpayer's signature line.

For The Taxpayer

The taxpayer must sign the form. If the taxpayer is a corporation, a duly authorized officer must sign the form. An attorney or an agent acting under "power of attorney" authorization may also sign the form. However, a copy of the REV 677 documenting this authorization must be attached to this form. The taxpayer must sign this form prior to the expiration of the statute.

For instance, if the period intended to be covered by the waiver is 2019, the taxpayer must sign this form by December 31, 2022.

The department will accept an electronic version of a hardcopy signed waiver (i.e., PDF), however the signer must provide an email or similar document acknowledging the authenticity of his/her signature on the electronic version of the signed waiver. The waiver and email must be saved in the audit file.

The department will accept an electronically signed waiver using a document signing software such as DocuSign. When using a document signing software, an email or similar document acknowledging the authenticity of the signer is not necessary.

Note: A cursive type signature such as available in Adobe is **not** acceptable as an electronically signed waiver.

Power of Attorney and Declaration of Representative (REV 667)

This form is used to document power of attorney authority vested by the taxpayer in another party or a declared representative of the taxpayer. This form may be included in the audit report when it is presented to the auditor by a representative possessing a Power of Attorney.

Notes:

- This form is not a Bureau's audit application document. The form is accessed from "Attachments" in the Bureau's audit application software. The PDF is a fillable document and must be completed manually.
- If directed to work with someone by the taxpayer, the power of attorney is not required. However, this form must be included in the audit report when the taxpayer's representative is signing documents that bind the taxpayer to certain actions or agreements, such as when the representative will be signing the waiver.

Link: [REV-677 Power of Attorney.pdf](#)

Completion of the Form

Part I

This section deals specifically with issuing “**Power of Attorney**” authorization. The taxpayer’s legal name, entity identification number, and correct mailing address must be provided. The correct name, address, and phone number of the individual(s) designated as the taxpayer’s attorney-in-fact must also be listed.

The authority is limited to representation for the “TYPE(s) OF TAX” listed on the form. “TAX YEARS OR PERIOD(s)” indicated on the form must cover the timeframe of the audit period. The representative is also limited to signing only those Department forms indicated under the “TAX RETURN/FORM” block. Auditors should instruct the taxpayer to indicate “*ALL*” in this block so that the representative can sign all audit forms as required. The taxpayer’s initials or signature for different statements on the form indicate additional restrictions on the exercise of the authority. The taxpayer should indicate “*audit*” under the “Purpose for Authorization” block.

The form specifically requires that if the named representative is not a certified public accountant, attorney, or enrolled agent, the taxpayer’s signature must be witnessed. Either obtaining the signatures of two witnesses or the proper authentication of the signature by a notary public satisfies this requirement.

Part II

This section of the form represents the “**Declaration of the Representative**”. The representative must indicate the number listed in this part of the form that best describes the representative’s capacity. The “*JURISDICTION*” must be listed as Pennsylvania. The representative’s “*SIGNATURE*” and “*DATE*” are both required.

Similar to a waiver, the department will accept an electronic version of a hardcopy signed POA (i.e., PDF), however the signer must provide an email or similar document acknowledging the authenticity of his/her signature on the electronic version of the signed waiver. The waiver and email must be saved in the audit file.

The department will accept an electronically signed waiver using a document signing software such as DocuSign. When using a document signing software, an email or similar document acknowledging the authenticity of the signer is not necessary.

Note: A cursive type signature such as available in Adobe is **not** acceptable.

Bureau of Audits-Registration Verification

Every audit report must contain a [Bureau of Audits – Registration Verification](#) form – This form is used to verify the accounts of registered taxpayers

NOTE: The form is accessed from “Attachments” in the Bureau’s audit application software. The PDF is a fillable document and must be completed manually.

Instructions

The Bureau of Audits – Registration Verification form should be presented to the taxpayer during the pre-audit conference for completion. When the form is completed and returned to the auditor, the auditor should verify all sections of the form have been properly completed. This information should be cross-referenced to the Customer and Account springboard in PATH and the Dept. of State's website (i.e., legal name). The auditor must follow-up with the taxpayer on any discrepancies. Any incorrect information listed on the form should be amended by the taxpayer by initialing the change on the update form or a new form should be completed by the taxpayer with the correct information. Any changes to the information listed in PATH such as the business address should be confirmed with the taxpayer. Once confirmed, advise the taxpayer to make changes via [myPATH](#).

It should be noted the information residing in PATH will provide detail registration information for each account for the taxpayer. To verify information for a sales and use tax account, the Account springboard should be selected along with the Registration tab. The Bureau of Audits-Registration Verification form is the controlling document for assessing sales & use tax; therefore, it is imperative that the information on this form is correct and properly corresponds to the information listed on the *Audit Report & Basis of Assessment* form in the Bureau's audit application software.

In addition, the auditor should take special note of changes in ownership (entity changes), bulk sale, or merger information if indicated on the form. If the taxpayer answers yes to any of the questions, the auditor must follow-up with the taxpayer. These actions may require the creation of additional audit assignments.

A copy of the form must be included in the audit report.

If the taxpayer refuses to complete the *Bureau of Audits-Registration Verification* form, the auditor is required to complete the form using all available information.

At the conclusion of the audit, the same procedures noted above for verifying information on the *Bureau of Audits-Registration Verification* form should be performed. If differences still exist, they must be corrected prior to submitting the report for assessment. Special attention should be made to the following items as they have a direct impact on the Department's ability to collect the liability. These items include:

Box I- Enterprise Legal Name

This is the legal name of the entity being assessed. The legal name listed in this box must be compared to the legal name listed in PATH and the Dept. of State's website. For a sole proprietor, the legal name is the same as the owner's name. For a partnership, the legal name is the name listed in the partnership agreement. In the absence of a written agreement, the legal name is the trade name. For a corporation, the legal name is the name listed in the Articles of Incorporation, State Charter, or another governing document.

Box 2- EIN

If a taxpayer has an Employer Identification Number (EIN), this is the entity identification number under which assessments are issued. EIN information can be compared to the EIN listed under the Account springboard, Registration tab of PATH.

Box 6-Enterprise Mailing Address

This address is where the taxpayer prefers to receive mail, may be the same as #5 and # 7.

Box 7- Current Assessment Only Mailing Address

This is the address where the taxpayer prefers to receive the Notice of Assessment for the current audit. Maybe the same as #5 and #6.

Box 8- Form and Type of Organization

While this piece of information is not recorded on the assessment, the auditor must ensure that the Department's records reflect the correct entity type. It is part of identifying the correct entity.

The taxpayer may indicate in this section that the enterprise is a Limited Liability Company (LLC). An LLC is an entity formed under state law by filing articles of organization as an LLC. For Pennsylvania purposes, the LLC is classified as neither a corporation nor a partnership but rather is a specific type of entity termed "Limited Liability Company"; however, an LLC elects how it is treated for federal income tax purposes. For example, an LLC may elect to be treated as corporation and file FF1120 or elect to be treated as partnership and file FF1065. The election does not change the entity status of the LLC.

For purposes of Pennsylvania sales and use tax, an LLC in all instances will be considered a legal entity and will require a sales and use tax license.

During the course of an audit, the auditor may use the LLC filed federal income tax return (1120, 1120S or 1065) to verify gross sales, assets acquired (depreciation schedules), or taxable expense purchases. A single member LLC where the member is an individual will report his/her income on PA and Federal Schedule C.

Box 14-Bulk Sale or Merger

If the taxpayer indicates a bulk sale occurred during the audit period, the auditor should request a copy of bulk sale clearance certificate. If a bulk sale clearance certificate was not obtained, the auditor should request a copy of the asset purchase agreement and document the purchase of assets in the narrative. The supervisor must notify headquarters personnel through the *Additional Headquarters Processing Request* form to request that a bulk sale assessment be issued against the purchaser of the assets indicating, purchasing entity's name, EIN, account number, and the date of the bulk sale. The assessment will consist of liabilities incurred by the seller on or before the date of transfer.

If the auditor is auditing a corporation that merged into another non-registered corporation designated as the survivor (review Dept. of State's website) then a new assignment and Sales and Use tax account must be issued to the surviving corporation. Any assessment will be issued in the name of the surviving corporation.

If the auditor is auditing a corporation that is the survivor of a merger and the corporation is registered with no changes in EIN, then no additional action is required.

Box 16- Owners, Partners, Shareholders, Officers, Responsible Party Information

Except for sole proprietors, ownership information is not reflected on the assessment. However, this information must be correct on *Bureau of Audits Registration Verification* form so that the Department may issue *Responsible Party Assessment* (RPA), if applicable. Partners in a partnership are jointly and separately liable for the assessment. In addition, certain types of assessments may be issued against the listed corporate officers if the corporation fails to pay the assessment. In addition, the social security number listed for a sole proprietor serves as the entity identification number under which the assessment is issued in the absence of an EIN.

NOTE: If the information indicates that the taxpayer must register for sales and use, PTA, or VRT tax, the auditor must instruct the taxpayer to complete application online via "Pennsylvania Online Business Tax Registration" in [myPATH](#).

Box 17-Multiple Establishment INFO

All Pennsylvania business locations must be listed. A list of Pennsylvania locations must be attached to the *Bureau of Audits Registration Verification* form if space on the form will not accommodate listing all locations.

Entity Changes

If the *Bureau of Audits – Registration Verification* form discloses a FEIN change or an ownership change occurring, a new assignment number is required. A name change, change in corporate stockholders and/or officers, or changes in the number of partners with no changes in FEIN requires no additional actions other than processing the appropriate updates.

Refer to [Chapter 8](#), Entity Changes for further detail.

Requirements for the Audit Review of Third Party Credits

This form outlines the Department's position regarding the documentation required to substantiate the granting of third-party credits in the audit findings.

The auditor must identify a date by which documentation supporting the taxpayer's request for third party credit must be submitted to the auditor for credit to be considered in the audit findings.

This form must be presented to the taxpayer during the pre-audit conference. The auditor must explain the information contained on the form and answer the taxpayer's question related to the form.

The auditor should secure a signature from the taxpayer's representative.

The form is required documentation in the audit report.

Tally Sheet (REV-153)

The [REV-153 Tally Sheet](#) form is designed to accurately record taxable and nontaxable sales in progress during a sample audit period for the purpose of establishing the percentage of taxable to gross sales ratio and the effective rate of tax.

Additional Headquarters Processing Request

This form is used to notify headquarters of processing requests and the results of special instructions. In addition to the items specifically listed on the form, these instructions may include processing tax returns, account cancellation requests, penalty abatements, imposing major penalties and documents to appropriate personnel such as a Business Activities Questionnaire, etc.

When the *Additional Headquarters Processing Request* form is included with an audit report, the "Y" should be populated in the *Sales and Use* tab of the "Taxpayer's Information" folder in the Bureau's audit application software by checking the "HDQ 1105".

Checking the HDQ 1105 box in the Bureau's audit application software is independent from the completion of the *Additional Headquarters Processing Request* form.

Completion of Form

This form is completed and signed by the auditor or supervisor. Supporting documentation needed to take the actions indicated on the form must be attached to the form. The completed form and attachments are scanned and saved in the audit folder uploaded to HQ.

The auditor must notify the supervisor of any additional processing requirements.

Business/Account Cancellation Form (REV-1706)

A cancellation of a license should be performed online by the taxpayer via [myPATH](#). If the taxpayer is unable to cancel the license on-line, a paper copy of the [Business/Account Cancellation Form \(REV-1706\)](#) form should be prepared and submitted to HQ via the *Additional Headquarters Processing Request* form.

Instructions for completion are provided below.

Completion of Form

The auditor must be certain of the following:

- License number is correctly recorded.

- Owner(s) name and trade name(s) is included.
- Correct date and reason the business was discontinued is given.

If there is a change in entity, the cancellation must be prepared for the entity that has discontinued business and the new entity must register online through the “Pennsylvania Online Business Tax Registration” via [myPATH](#) to obtain a new license number. This procedure must take place pursuant to the conduct of the audit and processed prior to the completion of the audit.

If necessary, the auditor may complete and sign the form directly so that the appropriate accounts can be canceled.

This form must be typed or completed in ink.

Notice of Assessment

This is the audit assessment notice mailed to the taxpayer. The information is based on the audit information uploaded by the region into the Department’s computer files. The legal name, mailing address, FEIN and Sale License ID are all based on updated information provided by the taxpayer via the [Bureau of Audits – Registration Verification](#) form. The tax period beginning and ending dates reflects the audit period to which the assessment pertains. The information in these fields should match the information provided on the [Bureau of Audits Registration Verification](#) form. These fields must be correct. The Letter ID is computer generated and represents the assessment number. A copy of the Notice of Assessment is generally not included in the audit report.

Explanation

Audited Liability

This amount represents the gross deficiency from the audit.

Interest Forecast

Total interest due on outstanding deficiency. Interest is calculated on a daily basis using an annual interest rate that varies by calendar year.

Penalty Forecast

The penalty is calculated by 5 percent of the unpaid tax for each month or fraction of a month from the original filing date of the sales and use tax return.

Payments/Credits

This amount represents any payment or credits made through the audit.

Total Due

This total represents net amount due after any payments or credits are applied to the liability. This total is broken down by tax, interest, and penalty.

Issuance

The assessment notice must be mailed to the taxpayer's mailing address listed on the Audit Report and Notice of Assessment form. If the taxpayer requests the assessment be mailed to another location, the taxpayer must submit the request in writing on company letterhead or email. The auditor must forward the request to headquarters attached to the Additional Headquarters Processing Request form with a note to send of a copy of the assessment to the address listed in the letter or email. The Notice of Assessment may also be viewable in [myPATH](#). It will be viewable in myPATH for any Web Logon that has access to the Sales and Use Tax Account. Refer to [Notice of Assessment & Audit Basis of Assessment](#) procedures.

Secretary's Writ

A Secretary's Writ may be used when the Department determines that it is necessary to issue a formal demand for access to the financial records or for information pertaining to the tax matters of a particular individual or business. Refer to the previous discussion of this form in Chapter 3 [Secretary's Writ](#).

Penalty Abatement Forms

These forms are used to recommend and approve administrative abatement of penalty at the audit level if the criteria are met based on Penalty Abatement Policy in [Chapter 8](#).

If penalty abatement is being recommend, a statement must be included in the Post Audit Conference section of the narrative that indicates penalty abatement was recommended and the taxpayer was advised that completion of the penalty abatement form did not preclude the taxpayer from petitioning the Board of Appeals on any areas of disagreement.

Penalty Abatement Approval Form

The [Penalty Abatement Approval Form](#) is to be completed prior to providing a [Penalty Abatement Petition Form](#) to the taxpayer or their representative. This approval form needs to be reviewed and approved by the audit supervisor. This form is available as a template in the Bureau's audit application software.

Penalty Abatement Petition Form

The form must be signed by the petitioner, officer, or authorized representative and approved by the audit supervisor. The taxpayer should be advised that completion of this form is no way

limits or reduces their rights to appeal any notice of assessment they may receive. This form is available as a template in the Bureau's audit application software.

NOTE: Both the *Penalty Abatement Approval Form* and the *Penalty Abatement Petition Form* must be included with the *Additional Headquarter Processing Request* form. The form **must** not be included in the audit report as an exhibit or form.

Audit Staging and Attributes

The Pennsylvania Tax Hub (PATH) tracks assigned, in-progress and completed assignments. Prior to submitting the audit report for assessment, the auditor and supervisor must make sure that PATH is staged appropriately, and information is updated in the "Attributes" panel and tab in the Audit springboard to reflect the information recorded on the Audit Report and Basis of Assessment. This includes audit period, pre and post audit conference dates, waiver dates, assessed amount, non-assessed amount, credits, and hours charged to the assignment. The information must also be consistent with the information listed on the *Bureau of Audits – Registration Verification* form.

Multi-Region Audit Assignment

When more than one region is conducting an audit on the same assignment number, the lead auditor is responsible for coordinating the presentation of the final audit report. This must be planned prior to the start of the fieldwork so that all the work performed by the other region may be merged into one audit package. The Bureau's audit application software allows for the merging of forms and schedules created by a second region.

Submission and Distribution of the Report

The "Final" audit report must be submitted to HQ within 15 calendar days of the post audit conference. The assessment date is five days after the audit report is submitted to HQ.

Currently, a copy of each audit report is stored on the HQ's server and is available through the Audits Main Menu in [PA DOR BRIDGES](#) and in PATH. Original documents that are scanned to the audit report must be maintained in the regional office.

The "Audit Basis of Assessment" can only be made available in myPATH to one Web Logon. If the "Audit Basis of Assessment" is unable to be made available in myPATH, then an electronic version of the audit report via a CD-ROM is mailed with the Notice of Assessment. All forms, reports, schedules, and exhibits are included with the audit report, except for the *Conflict of Interest Statement & Auditors Comments* form.

Individuals requesting copies of an audit report must be referred to headquarters. The request must be submitted in writing on the taxpayer's letterhead and must be signed by the employee of the taxpayer who is on record as representing the taxpayer throughout the audit, corporate officer, or POA. Upon formal written request approved by the sales and use tax program administrator, the taxpayer will be provided a copy of the audit report.

Corrections to the Findings

When errors are found in the audit findings during regional review prior to submitting the audit report to HQ, the auditor must perform the following:

- Correct the schedules in the Bureau's audit application software.
- If changes are made to supplemental schedules, then the excel spreadsheet must be updated and the supplemental schedules must be re-imported into the Bureau's audit application software. The supplemental schedule should have the same title as the excel spreadsheet.
- The Sales and Use Report must be re-run.
- Refresh the tokens on the Audit Report and Basis of Assessment and the Taxpayer's Acknowledgement of Post Audit Conference form so the correct tax is populated in these forms.
- The applicable sections of the narrative must be updated to reflect the correction.

All of these steps are required in order to correct the assessment amount.

Note: If the corrections that were made increased the audit deficiency than the auditor must conduct another Post Audit Conference with the taxpayer.

CHAPTER- 8 AUDIT POLICY

This section of the manual describes the policies to be used by auditors in addressing certain audit issues.

Audit Period-Statute of Limitations

The statute of limitations discussed below applies to:

- State and Local Sales, Use and Hotel Occupancy TAX (SLS)
- Public Transportation Assistance Fund Taxes and Fees (PTA)
- Vehicle Rental TAX (VRT)

General

The audit period is normally established during the pre-audit conference. The standard audit period for a taxpayer is the previous three calendar years and all of the current year's returns due as of the preaudit conference date (see **72 P.S. §7258**).

Exceptions

The auditor shall not assess beyond the standard audit period except for audits involving the following:

Non-Filed Returns (72 P.S. § 7259)

For non-filed returns, or false or fraudulent returns, the Bureau will **only** assess sales tax collected not reported for the three years prior to the standard audit period. Any assessment beyond the three prior calendar years requires approval of the Program Administrator.

The under-reporting of collected sales tax as a result of filing a false or fraudulent return. (72 P.S. § 7260)

Any assessment of the under-reporting of sales tax as a result of filing a false or fraudulent return requires the approval of the Office of Chief Counsel. The request for the approval should be forwarded to HQ using the “*Assessing Beyond Original Audit Period Approval*” form in the audit application.

Properly executed Consent to Extend Time Limit for Assessment/Determination of Tax and to Extend Period of Time for Record Retention (Consent/Waiver)

Sales tax on additional taxable sales and/or use tax on additional taxable purchases shall not be assessed beyond the standard audit period without a properly executed waiver.

Extension of the Audit Period for Assignments

Taxpayer's Request

Requests by the taxpayer to bring the audit period current should be honored if the following criteria are met:

- The taxpayer provides a written request on their letterhead or email for the audit period to be extended and that they agree to allow the auditor to project test results from previously selected test periods against the extended periods.

Note: Projection of third-party credits from an SRS may be projected against the extended periods upon approval of the Program Administrator.

- Business activities in the extended period are consistent with business activities included in the original audit period. For example, if average expenses were used to choose a test period for expenses, expenses incurred during the extended period must be reasonably consistent with that average.
- Prior to projecting to the extended periods, the auditor should verify that the reporting of sales and use tax in the extended periods were consistent with the original audit period.
- The taxpayer makes the necessary sales and expense information available to properly extend a projectable average based on either test periods in the original audit period, or a projectable average based on the original audit period when a complete examination was conducted.
- The taxpayer makes the necessary capital purchase documentation available for the extended period.

Length of Time Necessary to Complete the Fieldwork

Once waiver extensions exceed 18 months from the original statutory deadline, regions are required to bring audit periods forward before authorizing additional waivers or request the follow-up collateral audit. Any waiver extending the original statutory deadline beyond 18 months is only to be granted with a taxpayer commitment to an audit timeline in writing or with a taxpayer signed Audit Plan. Any exceptions to the above require Program Administrator approval.

Example:

During the pre-audit conference, the original audit period is determined to be 1/1/2019 – 6/30/2022. The original statutory period for tax year 2019 expires 12/31/2022 so for any waiver extending the statute pass 6/30/2024 the audit should be extended to 12/31/2023 or a collateral audit must be requested for the period beyond 6/30/2022.

The auditor must verify the following prior to extending the audit period:

- Business activities for the extended periods are consistent with the original audit period.
- Reporting of sales and use tax for the extended periods are consistent with the original reporting period.
- A reasonable projectable average can be determined for both sales and expenses.

The taxpayer should be presented with a *Request for Financial Records* form which specifically requests information for capital purchases and the sales and expense totals necessary to apply the projectable averages from the original audit period over the extended period.

Note: Projection of third-party credits from SRS may be projected to the extended periods upon approval of the Program Administrator.

The taxpayer should also be presented with a *Taxpayer's Concurrence with Test Audit Plan* containing an explanation of the procedures to be used to determine the liability or credit for the extended period. The taxpayer must be given an opportunity to state, in writing, reasons for objections to the extension of the audit period. The auditor must address any taxpayer objections and their relevance to the reasonableness of the procedures used to determine the liability or credit for the extended period.

If the necessary sales or expense totals are not provided for which to apply the projectable averages from the original reporting period, assessment for the extended audit periods should be based on an average net deficiency (or credit) identified in the original audit period.

If the necessary capital information is not made available, the average net deficiency (or credit) identified in the original reporting period should be applied to each reporting period in the extended period (**subject to materiality**).

Bankruptcy Audits

Procedures

When an auditor receives a field audit request on a bankrupt taxpayer, it must be given **priority** status.

Bar Date

- The auditor is to contact the bankruptcy court and obtain the bar dates, both general and governmental (*a/k/a administrative*).
- The bar date is the last date to file a claim.
- The audit must be submitted at least thirty days prior to the first bar date.

- The auditor should note that this is different than the normal nine-month period given to other priority audits.

Research

- In most cases, the bankruptcy filing will be noted in PATH and in Bridges; however, if the petition was not filed in PA or the taxpayer under audit is not the primary petitioner, it will not appear in Bridges.
- As part of the pre-audit conference, the auditor should inquire as to any open bankruptcy proceedings.
- If the auditor identifies an open bankruptcy, notify HQ as soon as possible.

Pre and Post-Bankruptcy Periods

- The tax liabilities established must be separated into pre- and post- bankruptcy periods.
- The auditor must separate the findings in accordance with the date the taxpayer filed for bankruptcy.
- If the audit identifies any liability, the auditor must prepare separate audit reports for the pre- and post-bankruptcy periods. Each report will be issued under its own assignment number and separate assessments will be issued.
- Bankruptcy information should not be included on the Audit Report and Basis of Assessment form of the post-bankruptcy assignment.
- Instead, the Additional Headquarters Processing Request form should indicate that it is a post-bankruptcy assignment and provide the bar date.

Bankruptcy information is to be reflected in the appropriate section of the Audit Report and Basis of Assessment as well as the preaudit section of the narrative.

Multi-Court Voice Case Information System (McVCIS)

McVCIS (*pronounced "nac-vee-sis"*) allows the auditor to contact any U.S. Bankruptcy Court's computer from any touch tone telephone at the toll-free number 866-222-8029.

Obtain the following case information:

- Case number
- Names of debtors or principal adversaries
- Case filing date
- Case chapter
- Name of debtor's attorney
- Name of trustee
- Discharge and closed dates

- Status of Case
- Whether or not the case has assets
- Telephone number of debtor's attorney
- Deadlines for filing proofs of claim
- First meeting of creditors date

The service is available 7-days a week, 24 hours per day. Because the information is retrieved from court's database, the reported information is the most up to date information available.

When using McVCIS, the computer will direct the user through a series of questions. The following information should be obtained from the taxpayer prior to the call.

Information to obtain prior to the call:

- The state where the bankruptcy was filed. Typically, this is state where the taxpayer is incorporated.
- Court District:
 - *Western*
 - *Middle*
 - *Eastern*
- Taxpayer's FEIN or SSN
- Bankruptcy Cause Number

Prepare to take notes through the call and document the administrative and governmental claim (bar) dates. If the dates are not available, it is more than likely these dates have not been established by the courts. Make a note to check every couple of weeks until the dates are posted.

Note: Some bankruptcy courts have a web page that will provide you with information about bankruptcy filings in their state.

Field Bankruptcy Notification Form

Should an auditor discover that the taxpayer on any assignment currently in inventory has declared bankruptcy, they will use the [Field Bankruptcy Notification](#) to advise headquarters of the bankruptcy status so that the Bureau of Compliance and Office of Attorney General may be informed. The information obtain from the MCVCIS will be used to complete the form.

Billing for Out-of-State Audit Expenses

When audit time is wasted and return trips had to be made on out-of-state sales and use tax audit assignments because the taxpayer did not have the records available for audit or when unreasonable delays were encountered waiting for records to complete the audit, the Department may bill the taxpayer for the cost of the return trips. This is addressed in the out-of-state engagement letter.

An out-of-state audit engagement form letter is initially sent to announce the audit and to advise all out-of-state taxpayers that if return trips are required because of unreasonable delays in providing records, the statutory provision for billing out-of-state audit expenses may be invoked.

Bulk Sales Assessments

When an audit assessment is being issued against a taxpayer who has transferred 51 % or more of a class of Pennsylvania assets (bulk sale), a bulk sale assessment shall be issued as an operation of law against the purchaser (**72 P.S. Section 1403**). An asset is defined as any stock of goods, wares, or merchandise of any kind, fixtures, machinery, equipment, buildings, or real estate, located in Pennsylvania. The bulk sale assessment is issued against the purchaser to protect the Commonwealth's interest in any Pennsylvania taxes due related to the assets sold.

The PA Department of Revenue must be notified **10 days** prior to the sale or transfer in bulk of 51% or more of any stock of goods, wares, or merchandise of any kind, fixtures, machinery, equipment, buildings, or real estate, located in Pennsylvania. The transfer of assets does not have to be 51% or more of total assets located in Pennsylvania but 51% or more of a class of assets located in Pennsylvania. Failure of the seller to obtain a Bulk Sale Clearance from the Department makes the purchasers or assignees, as well as the seller/assignor, jointly liable for all taxes incurred up to, and including, the date of the sale or transfer.

If a "*Bulk Sale Clearance*" certificate has been issued, the taxpayer should provide the clearance certificate to the auditor. If it is questionable whether a bulk sales clearance has been issued, contact HQ personnel. HQ will contact the Bureau of Registration and Taxpayer Management to determine if a clearance certificate was issued. When the seller has failed to obtain a Bulk Sale Clearance, the company under audit will be assessed and the auditor will request a bulk sale assessment, via the Headquarters *Additional Headquarters Processing Request* form, against the purchaser or assignees of the assets. Attach a copy of the sales agreement to the processing form, if available.

The auditor should review question 14 of the *Bureau of Audits – Registration Verification* form, registration springboard of taxpayer's PaTH account or inquire at the pre-audit conference to determine if the taxpayer was involved in a bulk sale transaction.

Business Activities Questionnaire

The Business Activities Questionnaire [Business Activities Questionnaire \(REV-203D\)](#) located on the Department's website is used by the Bureau of Registration and Taxpayer Management to determine if out-of-state vendors selling property within the Commonwealth have physical or economic nexus.

The Bureau of Audits may use the form in those instances where an entity under audit has non-registered affiliated entities making sales in Pennsylvania with a potential sales or corporation tax liability. The auditor should request the affiliate to complete the questionnaire to determine if the entity has physical or economic nexus in Pennsylvania. If the auditor determines the non-registered entity has nexus, the auditor should request the entity register with the Department and an audit should be conducted for tax compliance, if warranted.

The completed “*Business Activities Questionnaire*” should be attached to the Department’s *Additional Headquarters Processing Request* form as part of the completed audit report.

The date and place of follow up contact to set an appointment for the conference must be described. If numerous attempts were necessary to establish contact, then this section of the narrative should reference an exhibit that documents each attempt. The narrative must reference any additional correspondence with the taxpayer with appropriate references to exhibits (i.e., *confirmation letter*). Any taxpayer’s requests to postpone the audit for a significant length of time should be in writing and exhibited in the audit report.

Consolidation of Entities for Sales and Use Tax Audits

If an entity under audit requests, in writing, that the parent, subsidiaries or any other separate legal entities such as an LLC, partnership etc...be assessed under one sales and use tax license number, the Bureau can accept the letter and assess two or more different entities with separate Employer Identification Numbers (EIN) under the one sales and use tax license number. The letter should list the legal name, EIN and sales/use tax license of the entities being assessed under the one license number. The letter must be signed by a corporate officer or POA and included as an exhibit in the audit package and fully explained in the audit narrative.

The Registration Verification form must include all Pennsylvania locations for all the entities being assessed under the single sales and use tax license. Also note on the “Additional Headquarters’ Processing Request” form that two or more separate legal entities are being assessed under one license number.

Coupon Sales

Amounts representing a stores or manufacturer’s coupons shall establish a new purchase price if both the item and the coupon are described on the invoice or cash register receipt.

If “the receipt shows only that the coupons were redeemed, but does not describe them,” the taxable purchase price is not reduced. **Myers V. Commonwealth**, 260 A.3d 349 (Pa. Commwlth.2021), 67 & 68 MAP 2021.

For example:

*A customer purchases two hamburgers (taxable) with a “buy one burger get one free” coupon and a bottle of unflavored water (nontaxable). The price of one hamburger is \$2 and the unflavored water is \$1. The establishment should ring up \$5 on the cash register and enter a \$2 credit for an adjusted purchase price of \$3. If the coupon and the burger are described on the cash register receipt, sales tax is due on the adjusted taxable purchase price of \$2. If the coupon and the burger are **not** described on the cash register receipt, sales tax is due on the original taxable purchase price of \$4.*

Credit Memos Issued by the Department

The procedure of applying previously approved tax credits in one general fund tax prior to the computation of penalty and interest is authorized under Section 1108(b) of the Fiscal Code (see **72 P.S. §1108(b)**). This section also authorizes the application of assigned credits from one taxpayer to the taxpayer that is assessed.

Auditors may not allow as an offset any liabilities identified through an audit with any credit amounts that originate from an official “*Credit Summary Notice*” issued by the Bureau of Business Taxpayer Accounting.

Normally, a “*Credit Summary Notice*” will be issued as a result of a refund order issued by the Board of Appeals or Board of Finance and Revenue. Such credit notices can be used by the taxpayer in lieu of a cash or check payment and can be applied to any subsequent sales and use tax return filed with the Department.

It is important that all audit liabilities are officially assessed. Subsequently, the liability may be satisfied by a taxpayer presenting a “*Credit Summary Notice*” in payment of part of that audit liability, in lieu of tendering a check or cash. The “*Credit Summary Notice*” must be physically surrendered to the Department so that the taxpayer does not erroneously receive duplicate credit.

Determination of Fair Rental Amounts Between Affiliated Interest

It is necessary to have uniform application in establishing a constructive fair rental charge between affiliated interests consistent with **61 Pa. Code § 47.16**. “Rental of Equipment between Affiliated Interests”.

An affiliated interest exists when two corporations, associations, partnerships, proprietorships, or other businesses, in which one corporation, association, partnership, proprietorship, individual or other business owns more than 50% of the stock or assets, including inventory, machinery and equipment of the remaining corporation, association, partnership, proprietorship or other business. Also, the common ownership of more than 50% of the stock or assets of each of two or more business entities results in an affiliated interest between the two commonly owned entities.

The following procedures are to be using for affiliated Interest:

- In instances where property is owned by one entity and is being used by an affiliated entity, the audit must determine:
 - If there is consideration between the two parties.
 - Whether the consideration is at arm’s length.
- If the auditor questions the amount of consideration between the two parties as being a fair rental charge, an explanation must be provided in the audit report. The consideration transferred must be documented to support a “sale at retail.” To be considered an arm’s

length transaction, the fair market rental value will be considered to be the prevailing market rate (by hour, day, or month).

- The auditor should document the determination of the fair market value established by use of supporting documentation such as rate schedules or price lists.
- In situations where a fair rental amount is not at arm's length and the prevailing market price cannot be determined, the auditor should apply a "percentage of costs" (4% of the purchase price per month on most items, 3% on cars, and 2% on airplanes). One method to determine if the rental charge is reasonable is to examine the net profit (loss) of the lessor. If a reasonable profit has been made, it is assumed to be a fair value charged.
- If there was no consideration involved in the transaction, the affiliate originally acquiring the property would be liable for tax on the purchase price. The resale exemption does not apply since the affiliate acquiring the property did not purchase it for resale but placed the property to a taxable use by providing to the other affiliate.

Drop Shipments

Drop shipment is a term adopted for a situation in which a customer purchases tangible personal property from a vendor. The vendor then directs a third-party vendor to ship or deliver the tangible personal property to a Pennsylvania location. In this situation, we are typically auditing the third-party vendor who is the taxpayer.

Example:

- A retail customer purchases taxable property from a nonregistered out-of-state vendor who does not have physical or economic nexus with Pennsylvania.
- The out-of-state vendor purchases the property from the taxpayer and claims the resale exemption on the purchase of the property.
- The taxpayer then ships or delivers the property to the retail customer in Pennsylvania.
- The nonregistered out-of-state vendor invoices the Pennsylvania based customer for the taxable property.

The Bureau will accept a resale exemption certificate obtained by the taxpayer without a sales tax license number from the nonregistered out-of-state vendor provided the certificate includes a statement indicating the out-of-state vendor does not have physical or economic nexus with Pennsylvania.

Note: Any drop shipments from an out-of-state vendor totaling over \$100,000 during a calendar year establishes economic nexus pursuant **SUT Bulletin 2019-01**. If the sales or payable examination identifies a nonregistered out-of-state vendor with transactions totaling

\$100,000 or more during the calendar year, forward copies of the invoices on the *Additional Headquarter Processing Request* form notifying HQ of the vendor's economic nexus.

Erroneously Charged Sales Tax On Sales/Installation of Real Property

The offsetting of erroneously charged sales tax against the sale/installation of real property (incurred use tax) in conjunction with a first-time audit is an administrative policy.

Sales taxes which have been erroneously collected and remitted to the Department will offset any use tax liability found to be due and owing by the contractor in a first-time audit. This is to be applied on an individual transaction or contract basis. That is, sales tax erroneously collected on one contract can only offset the use tax due from that specific contract. Additionally, if the contractor erroneously takes a T.P.P.R credit on the sales/use tax return for the purchase of property installed as part of the construction contract, the Department will allow the T.P.P.R. credit in a first-time audit.

Note: The Department will not issue a third-party credit on sales tax properly charged on the payable invoice for property installed as part of the construction contract.

No credit or refund will be granted to the contractor for erroneously collected sales tax after applying such collections against use tax due upon purchases used in the performance of realty construction activities.

The contractor will be notified in writing at the conclusion of the audit if a customer later files a petition and receives a refund of erroneously paid sales tax. The contractor will be assessed for the amount of tax refunded to its customer on the basis that the property was used in the performance of realty construction activity. **See, 61 Pa. Code § 31.12(a)(1).**

The policy will be extended on the condition that the contractor agrees to correctly apply the provisions of the sales tax law with respect to future transactions. The contractor will also be advised in writing that the Department will employ procedures to ensure compliance with the law on a prospective basis.

The contractor's written notice will state that the Department will not extend the policy subsequent to the date of formal advisement that their procedures were in error. In subsequent audits, use tax will be assessed on all purchases not properly taxed by the vendor. No offset for sales tax collected will be granted.

The auditor must notify the audit supervisor of the erroneous sales tax collected and remitted. The audit supervisor must then record this situation on the *Additional Headquarters Processing Request* form. It shall be the responsibility of Audit headquarters to prepare a letter formally notifying contractors of the conditions outlined above. A copy of this letter will be kept in the audit file and in Headquarters' files.

The taxpayer should be apprised of these conditions, and they should be addressed in the audit narrative.

Note: With the approval of the Program Administrator, this policy may be applied to other circumstances where the sales tax was erroneously charged, and a use tax liability resulted from the same transaction.

Computation of Tax When Sales Tax Is Not Separately Stated

Sales tax is required to be separately stated on the sales invoice pursuant to **61 Pa Code § 31.2** and charged on the total purchase price as defined by **61 Pa Code § 33.2**.

If an auditor encounters a situation where the taxpayer did not separately state the sales tax but computed the reported sales tax by dividing the “gross receipts by 1.06” and then subtracting this amount from the gross receipts, the auditor should re-compute the sales tax due as “gross receipts * 6%”. The difference would be assessed as additional sales tax due.

In these situations, the Program Administrator must be contacted prior to the conclusion of the audit.

In a first-time audit, taxpayers that do not separately state the sales tax on the sales invoice but reported sales tax in the manner noted above will not be assessed if the taxpayer acted in good faith, calculated the tax consistently throughout the audit period and was not previously notified by the Department regarding the computation of the tax. The taxpayer will be required to sign a prospective compliance agreement approved by the Program Administrator prior to the conclusion of the audit.

Note: This does not apply to operators of vending machines or amusement venues that have been granted permission to post the tax on the menu boards.

Interim/Temporary Storage

Interim/temporary storage involving possession of tangible personal property in Pennsylvania for any purpose including exercising any right or power over such property. Pennsylvania imposes use tax on such storage of tangible personal property within its boundaries.

When an item (purchase) is initially delivered to another state but subsequently brought into Pennsylvania, the Bureau of Audits will recognize a credit for sales/use tax paid to another state if that state taxes interim storage and has reciprocity with Pennsylvania. However, credit should not be allowed for tax paid if that state does not tax interim/temporary storage.

The following states tax temporary or interim storage; however, the rules governing the taxation vary from state to state. Any questions regarding a state’s taxation of interim/temporary should be directed to a Program Specialist in HQ.

States with Temporary or interim Storage

Arkansas	Iowa	Missouri	Ohio	Vermont
California	Kansas	Nebraska	Oklahoma	Washington
Colorado	Louisiana	Nevada	South Carolina	West Virginia
Florida	Massachusetts	New Jersey	South Dakota	Wisconsin
Georgia	Michigan	New York	Tennessee	Wyoming
Idaho	Minnesota	North Carolina	Texas	
Illinois	Mississippi	North Dakota	Utah	

Figure 8.1 States with temporary or interim storage

Institutions of Purely Public Charity (IPPCs)

IPPC Audits

When auditing Institutions of Purely Public Charity (IPPC) please note the following:

Exemption status

Exemption status of IPPCs will be granted beginning with the date of its initial application to the Department. The exemption status is not applicable to any activities prior to the initial application date.

Expired exemption status

In situations where the IPPC's exemption status expired during the audit period and there was an interim period prior to the renewal, and there wasn't any substantial change in the taxpayer's activities, the Department will honor the exemption status for the interim period upon renewal of the exemption.

Expedited Processing of Sales Tax Exemption Application

Supervisors must contact Bureau headquarters personnel to request expedited processing of pending Sales Tax Exemption Applications in instances where the outcome of an audit depends on the determination of the taxpayer's IPPC status.

Purchases by IPPCs

Purchases by IPPCs shall be billed to, and paid for by, the IPPCs.

Exemptions do not extend to the following purchases:

- Purchases made by individuals on behalf of the IPPC and subsequently reimbursed by the IPPC.
- Purchases for any unrelated trade or business; building material identified as non-BM&E, except for materials used in routine maintenance and repair; equipment used to repair, maintain, construct, and renovate real property; and hotel occupancy tax.

A construction contractor may purchase tax exempt building material identified as BM&E which is transferred pursuant to a construction contract with an IPPC.

An IPPC may use a [Tax Exempt Organization Declaration of Sales Tax Exemption \(REV-1715\)](#) form on purchases of \$200 or more. The obtaining of this form relieves the vendor of the “good faith” requirement in accepting an exemption certificate. This form does not relieve the IPPC of its liability if the purchase is later determined to be taxable.

Sales of food and beverages by a volunteer firemen’s organization to raise funds for the purposes of the volunteer firemen’s organization is not subject to sales tax. See **72 P.S. 7204(71)**.

Agency Agreements with Exempt Entities

The exemption afforded to exempt entities such as IPPCs and governmental agencies are not transferable; however, if an agency relationship exists between a non-exempt entity (agent) and the exempt entity, the non-exempt entity may use the exempt entity’s exemption to purchase property tax exempt. The following criteria must be satisfied in order for an agency relationship to exist.

Written agreement

The agency agreement must be in writing at the time of the transaction.

Disclosure

The agency or relationship must be disclosed on the payable invoice and the exemption certificate.

Agency Agreement statement

The agency agreement states that the principal will be bound by the action of the agent.

Valid Business Purpose

The agency itself must have a valid business purpose.

When auditing a vendor, the payable invoice and exemption certificate must disclose the purchaser is an agent for the exempt entity to claim the exemption. Any transactions involving agency relationships, refer the name of the agent to HQ for a collateral assignment; refer to [Chapter 6](#) Submitting Request for a Collateral Audit.

Locating Taxpayers

There will be occasions when regional audit office employees have difficulty locating a taxpayer who has been assigned for audit. In such situations, it is important to minimize the amount of unproductive audit hours expended by an auditor in attempting to locate the taxpayer. Regional managers are encouraged to use their supervisors to perform the necessary tasks required to locate the taxpayer. As a matter of policy, auditors should not expend more than 7.5 hours attempting to locate a taxpayer. After 7.5 hours, contact HQ for assistance.

When an audit assignment is received, the "Audit Engagement Letter" is to be forwarded to the taxpayer using the address provided with the audit assignment. If this letter is returned by the postal service as undeliverable or the auditor is unable to make telephone contact with the taxpayer, the audit assignment should be returned to the appropriate supervisor who will attempt to locate the taxpayer by using the following techniques:

- The registration tab in PaTH has three subtabs which includes phone numbers, email addresses, mailing addresses and physical addresses of authorized taxpayer representatives.
- Examine RK-1s or NRK-1s of the principal owners or shareholders to identify an alternative mailing address.
- Search the Internet for other possible locations or mailing addresses.
- If feasible, visit the physical business location of the taxpayer to determine if the business is still active. If active, ask for the principal owner of the business. If principal owner is not available, ask for the manager and request the principal owner to contact the Bureau by phone or email.
- If the above procedures cannot locate the taxpayer, contact headquarters for assistance.

Mergers

Assessments

When a corporation is merged into another, the surviving corporation is always responsible for all liabilities, including future tax liabilities, resulting from audits regardless of what statements to the contrary are in the plan or articles of merger. Therefore, where a corporation under audit has gone out of existence (O/E) or is pending out of existence (POE) as a result of a merger, the audit assignment on the non-surviving corporation should be cancelled and a new assignment should be created on the surviving corporation. A note should be included in the audit springboard of both assignments explaining the reason for the creation and cancellation of the assignments.

The Bureau will audit the business activities of the non-surviving corporation up to the effective date of the merger using standard auditing procedures.

Example:

An audit is issued on **ABC Corporation** for the audit period of 2019 – 2021. During the pre-audit conference it is discovered that **ABC Corporation** merged into **XYZ Corporation** as of June 30, 2020. The business activities of **ABC Corporation** should be audited for the period of January 1, 2019 – June 30, 2020, the effective date of the merger. Any assessment related to the business activities of **ABC Corporation** will be assessed against **XYZ Corporation**, the surviving entity.

Also, the business activities of **XYZ Corporation** should be audited for the periods under statute prior to the merger assuming **XYZ Corporation** had material nexus with Pennsylvania. Lastly the activities post-merger should be audited for the period of July 1, 2020 – December 31, 2021.

Any findings resulting from the business activities of **ABC Corporation** and **XYZ Corporation** will be assessed against **XYZ Corporation** under one assignment number; however, the audit report and schedules should separately address any assessment resulting from the business activities of each entity before and after the merger.

An assessment involving trust fund taxes (collected or withheld and not reported) for the period prior to the merger but discovered after the merger will be assessed against the survivor of the merger in accordance with **15 Pa. C.S. Section 1929 I**.

The auditor should review Question #15 of the *Bureau of Audits-Registration Verification* form and inquire with the taxpayer at the pre-audit conference as to any mergers during the audit period. Additionally, the auditor should review the Department of State's website ([Pa Department of State](#)) for any *Articles of Merger* filed with the state. If a merger occurred during the audit, the auditor must request a copy of the *Articles of Merger*. If the auditor is unable to get a copy of the *Articles of Merger* from the taxpayer, a copy may be requested from the Department of State by contacting headquarters.

Consent/Waivers

When a merger occurs and the surviving company executes a waiver, the waiver will apply only to the business activities of the surviving company prior to the merger unless the waiver specifically identifies the company that was merged out of existence. If the company that was merged out of existence was not specifically identified on the waiver, the out of existence company's business activities should be audited only for the statutorily available period as of the time the audit is conducted (three years plus the current year).

Example:

Using the example above, **XYZ Corporation** executes a waiver on December 1, 2022, holding open the 2019 tax year. Unless the waiver specifically identifies **ABC Corporation**, the Department may not assess the business activities of **ABC Corporation** as ABC was a separate legal entity during the 2019 tax year. In order to cover the pre-merger business activity for **ABC Corporation** and **XYZ Corporation**, the waiver should be completed as

follows:

Part I: Taxpayer Identification:			
Name:	XYZ Corporation (Successor to ABC Corporation, FEIN 12-3456789 SUT Licenses 99-999999)		
Street Address:	1234 Example Lane		
City, State ZIP:	York, PA 17408		
Part II: Tax and Identification Numbers:		Part III: Tax Period:	
Type of Tax:		Beginning:	01/01/2020
EIN:	999999999	Ending:	12/31/2020
Account ID:	100000000009	Corp Tax:	<input type="checkbox"/> 52 - 53 week filer
Part IV: Extended Assessment/Determination and Record Retention Date:			6/30/2024

Figure 8.2 Waiver Form Completion-Example 1

If **ABC Corporation** executed a waiver prior to the merger, any subsequent waivers must disclose the waived periods only apply to **ABC Corporation**.

Example:

ABC Corporation executes a waiver on December 1, 2022, holding open the 2019 tax year until June 30, 2023. On March 31, 2023, **ABC Corporation** merges into **XYZ Corporation**, the surviving entity. On June 1, 2023, the waiver is extended to December 31, 2023. The first waiver is still valid as it was executed prior to the merger; however, the second waiver must list the legal name of the **XYZ Corporation**, the surviving entity. The second waiver should be completed as follows:

Part I: Taxpayer Identification:			
Name:	XYZ Corporation (Successor to ABC Corporation, FEIN 12-3456789 SUT Licenses 99-999999) This consent to extend only applies to the business activities of ABC Corporation for the period of 1/1/2020-12/31/2020.		
Street Address:	1234 Example Lane		
City, State ZIP:	York, PA 17408		
Part II: Tax and Identification Numbers:		Part III: Tax Period:	
Type of Tax:		Beginning:	01/01/2020
EIN:	999999999	Ending:	12/31/2020
Account ID:	100000000009	Corp Tax:	<input type="checkbox"/> 52 - 53 week filer
Part IV: Extended Assessment/Determination and Record Retention Date:			6/30/2024

Figure 8.3 Waiver Form Completion-Example 2

This waiver discloses the periods being waived only apply to **ABC Corporation**. Although the waiver lists the legal name of **XYZ Corporation**, the Department cannot assess the business activities of **XYZ Corporation** as the statutory period for the 2019 tax year expired (December 31, 2022) prior to effective date of the merger (March 31, 2023).

Currently, the waiver generated by the Bureau's audit application software pulls in the taxpayer information from the "Taxpayer Information" tab. Therefore, it will be necessary to enter the additional information pertaining to the out-of-existence company on the face of the waiver. This can be done in the open space of **"Part I: Taxpayer Identification."** Enter as *"XYZ Corporation, as successor to ABC Corp Corporation., (EIN), (SUT account number)"*.

If the information will not fit on the face of the waiver due to more than one merged company, reference an attachment on the face of the waiver and include the information in an attachment.

Motor Vehicles

Demonstrator Vehicles

Recordkeeping

The maintenance of records regarding the usage of demonstrator vehicles is required as the primary method of demonstrating to the Department the taxable and nontaxable use of vehicles. Examples of records essential to the audit process include paperwork listing:

- A vehicle's date of acquisition and date of sale.
- Odometer readings at the time of acquisition and date of sale.
- Logs reflecting the taxable or nontaxable mileage accrued by individual vehicles.

Incomplete Records

In audits where adequate documentation is unavailable, the auditor will equate the vehicle's mileage (from date of acquisition) to months of taxable usage. For the purpose of this proposal, each 750 miles (or fraction thereof) of unrecorded mileage will be assessed one month of tax on the fair rental value.

Example:

If a vehicle subjected to audit has accrued 1200 miles since its acquisition and no records have been maintained to differentiate which of those miles were for nontaxable purposes, two months of use tax would be assessed on the vehicle. In no case will the total number of months assessed exceed the number of months the vehicle was in inventory.

Note: Templates are available in the schedules folder of the audit application to calculate use tax due for demonstrator vehicles.

Documentation of Actual Number of Months of Service

Should the dealer be able to document the actual number of months a vehicle is in service, the use tax assessment should not exceed the amount imposed for that number of months.

Example:

If the dealer can demonstrate with records that a demonstrator vehicle was only in the dealer's possession for three months, no more than three months of use tax could be imposed, regardless of the number of miles accrued.

Early Termination of Leases

Outlined below is the Department's position regarding the early termination of motor vehicle leases by a Lessee, a motor vehicle dealer, or upon receipt of an insurance company's payment. This reflects a change in policy as a result of recent Board decisions. If you have any questions, contact the HQ.

General Factual Scenarios

THE LESSOR'S BUSINESS:

The Lessor is in the vehicle lease finance business. As part of that business, the Lessor purchases vehicle lease contracts (and the related vehicles) from motor vehicle dealers ("Dealers") that entered into those leases with retail vehicle customers ("Lessees"). Those contracts provide the Lessees with possession of the vehicles in exchange for monthly lease payments.

Scenario 1: Lessee purchase transactions.

The first type of transaction is a "Lessee purchase transaction." In a "Lessee purchase transaction", before the scheduled end of the lease term, a Lessee contacts the Lessor because the Lessee wants to purchase the vehicle from the Lessor instead of continuing to lease the vehicle.

If the Lessee and Lessor agree to a purchase price, the Lessee and Lessor terminate the lease contract, the Lessee pays the Lessor the agreed to purchase price and ownership of the vehicle is transferred by the Lessor to the Lessee. The purchaser (former Lessee) purchasing the vehicle should pay sales tax at the time of registration on that entire purchase price because paying that sales tax is required for a certificate of title to be issued to the purchaser. See **72 P.S. §7238**.

DEPARTMENT'S POSITION:

It is the Department's position that in scenario 1, the former Lessee would be responsible for the sales tax when the motor vehicle is registered in Pennsylvania. No Public Transportation tax (PTA) would be due because the lease has been cancelled.

Scenario 2: Dealer purchase transactions.

The second type of transaction is a "Dealer purchase transaction." A "Dealer purchase transaction" is similar to a "Lessee purchase transaction", but in a "Dealer purchase transaction", the Lessee who desires to end the lease and purchase the leased vehicle or another vehicle brings the leased vehicle to the Dealer. It is the Dealer, not the Lessee, who offers to purchase the vehicle from the Lessor.

Similar to the “Lessee purchase transaction”, if the Lessor and Dealer agree to a purchase price, the Lessor and Lessee terminate the lease contract. The Dealer pays the Lessor the purchase price and ownership of the vehicle is transferred by the Lessor to the Dealer for resale to the Dealer’s customer (either the former Lessee or another customer). Neither the Dealer nor the Lessor are obligated to purchase or sell the vehicle to accommodate the Lessee. When the Dealer resells the vehicle to the former Lessee or another customer, sales tax is paid on the entire sale price of the vehicle because paying that sales tax is required for a certificate of title to be issued to the subsequent purchaser. See **72 P.S. §7238**.

DEPARTMENT’S POSITION:

It is the Departments position that in scenario 2, no sales tax or PTA tax is due on the sale from the Lessor to the Dealer because the lease contract is cancelled and the sale of the motor vehicle to the Dealer would constitute a sale for resale. The Dealer’s subsequent sale of the vehicle would be subject to sales tax.

Scenario 3: Insurance proceeds

The third type of transaction is the “receipt of insurance proceeds.” A Lessee purchases insurance from an insurer (“Insurer”) to cover damage to the vehicle or to cover theft of the vehicle. The Lessor is named as the loss payee in that insurance agreement. In the event that the vehicle is destroyed beyond repair or stolen, the Lessor receives insurance proceeds from the Insurer. The payment made by the Insurer is based solely on the fair market value of the vehicle, not lease payments outstanding at the time the vehicle was destroyed or stolen. The Lessee has no continuing obligations under the lease if the vehicle is damaged beyond repair or stolen.

When the Lessor receives the proceeds from the Insurer, the Lessor transfers ownership of the vehicle to the Insurer. If the vehicle is damaged beyond repair, the Insurer sells what remains of the vehicle to a salvage yard, and if a stolen vehicle is recovered, the Insurer sells the vehicle at auction.

DEPARTMENT’S POSITION:

It is the Department’s position that in scenario 3, no sales tax or PTA tax is due from the receipt of insurance proceeds because transfer of insurance proceeds by the insurance company is not in exchange for the tangible personal property, but to indemnify the Lessor for its property loss. In addition, provided the lease is then cancelled between the Lessor and Lessee, and the Lessee is not obligated to pay any part of the remaining lease payment, then no sales tax or PTA tax is due from Lessee to Lessor.

Reciprocity

Pennsylvania will grant credit for state sales and use taxes legally paid to another state, provided the state grants similar tax credit for taxes paid to Pennsylvania. Pennsylvania will also grant credit for local sales and use taxes, provided such taxes are:

1. Collected by the state and,
2. Paid pursuant to the provisions of the state law which has been adopted by the local government.

Maximum credit granted includes state and local sales and use tax, when indicated. Evidence showing tax has been paid must substantiate claims for tax credit. [Pennsylvania Sales and Use Tax Credit Chart \(REV-227\)](#) on the Department's website lists the reciprocity status of the other states as well as the sales tax rate of each state.

Reciprocal credit is only to be recognized when possession of tangible personal property is taken in a reciprocal state and subsequently brought into the Commonwealth.

Example:

If a Pennsylvania based company purchases \$1,000 worth of office supplies in Georgia, takes possession of the goods in Georgia, and pays the Georgia 4% sales tax (\$40.00), the transaction would be subject to an additional Pennsylvania tax of \$20.00 (6% of \$1,000 = \$60.00 less \$40.00 reciprocity credit) when the goods are brought into Pennsylvania.

However, if a taxpayer purchases tangible personal property from an out-of-state vendor who collected that state's tax and the taxpayer takes possession of the goods within the Commonwealth, the transaction is not subject to the reciprocal credit. The transaction would be fully subject to Pennsylvania tax and an erroneous overpayment of tax to the other state would exist.

Example:

If a Pennsylvania based company purchases \$1,000 worth of office supplies from a Georgia vendor, takes possession of the goods in Pennsylvania, and pays the Georgia 4% sales tax (\$40.00), the transaction would be subject to Pennsylvania tax of \$60.00 (\$1,000 x 6%). The Georgia tax (\$40.00) erroneously paid to Georgia cannot be offset as a reciprocal credit against the Pennsylvania tax of \$60.00 and the taxpayer would be entitled to a \$40.00 refund from Georgia.

When granting an interstate reciprocity credit for local tax, the credit will apply to state tax first and the remainder will apply to the local tax.

Example:

An Allegheny County taxpayer purchases \$1,000 worth of office supplies from an Ohio vendor, takes possession of the office supplies in Ohio and properly pays the Ohio sales tax of 6.5% (\$65). The transaction is **not** subject to Pennsylvania use tax as \$60 of the Ohio sales tax of \$65 would offset the state use tax liability of \$60. However, the transaction is subject to additional Allegheny local use tax of \$5. (7% of \$1,000 = \$70 less \$65 reciprocity credit). **61 Pa Code § 60.16(l)(1).**

When granting an intrastate reciprocity credit for local tax, a credit will be granted for the local sales tax that was legally due to the other taxable county upon purchase of the property.

Example:

A Philadelphia County taxpayer purchases \$1,000 worth of office supplies from an Allegheny County vendor and properly pays \$70 (\$1,000 x 7%) of state and Allegheny County local sales tax. The office supplies are used in Philadelphia County. The transaction is subject to additional

Philadelphia County local use tax of \$10. (8% of \$1000 = \$80 less reciprocity credit of \$70). **61 Pa Code § 60.16(l)(2).**

There are two provisions in the New York state sales tax law that could possibly affect the incidence of tax for Pennsylvania:

Receiving Bulk Property

The first exemption available to New York taxpayers involves the receiving of property in bulk. If the property is later distributed to various states, then the original acquisition of the property is exempt from tax. Therefore, if the records indicate that New York tax was paid on such acquisitions, it may be possible that the tax was not legally due to New York and the auditors should not apply any reciprocal credit. Instead, the full amount of the Pennsylvania sales tax is due on the property used within the Commonwealth and should be assessed.

New York Contractors

The second instance, which also involves the New York state sales tax statutes, regards New York contractors who acquire property within the state of New York and install such property outside their state. In such instances, the contractor is required to pay the tax at the time of purchase and apply for a refund from the New York State Tax Commission upon the installation of the property into real estate outside of New York.

The Department of Revenue does not allow credit for New York sales taxes paid when the New York state contractor acquires property within the state of New York, pays New York sales tax, transports the property to Pennsylvania, and upon installation in Pennsylvania, the property becomes real property.

The reason for disallowing this credit is the fact that the New York contractor has the legal right to obtain a refund or credit of the New York state sales tax originally paid on the property since that property is properly subject to tax in Pennsylvania.

(See New York law at CONSOLIDATED LAWS, CHAPTER 60 TAX LAW, Article 28 Sales and Compensating Use Taxes, Part III Exemptions. Sec.1119. Refunds or credits based on proof of certain uses--)

Audit Site & Records Location

All sales and use tax audits are to be performed at the taxpayer's place of business unless the taxpayer specifically requests that the auditor examine the records at the regional office or if there are other unusual circumstances in which it would not be prudent for the auditor to perform the audit at the taxpayer's business location. Regional managers may authorize exceptions to this requirement.

Unless there is an approved exception, the taxpayer will be provided at the pre-audit conference the ***Audit Site & Records Location Request*** form in the Bureau's audit application software and will be included in the Audit Report.

The following are exceptions where the form is not required:

- When the taxpayer requests the auditor to work onsite
- Audits conducted in regional office or telework.

Note: Audits where records are located at personal residence, or the taxpayer is identified in PATH as previously creating a potential safety concern should not be conducted onsite.

Removing Records from Audit Site

Prior to removing physical records, the auditor should inform the audit supervisor. The auditor is to give the taxpayer the *Record Removal Receipt* form located in the Bureau's audit application software that details receipt of all records removed. The form is to be signed and dated by both the auditor and the taxpayer. When records are returned, the same *Record Removal Receipt* form will be signed and dated by both the auditor and the taxpayer recording the fact that the taxpayer received all records originally removed. This form is to be included in the audit report and reference must be made in the narrative report explaining the reason for the removal of records.

Remote Auditing

When conducting an audit remotely the following parameters should be followed:

- Original taxpayer records should be reviewed from the regional office.
- Large volumes of taxpayer record copies that cannot be secured in filing cabinet provided for home telework should be reviewed from regional office.

Requesting Records

Requesting Records from Taxpayer

Any formal request for records should be documented on the Bureau's *Request for Financial Records* form located in the document folder of the Bureau's audit application software.

If the taxpayer does not provide the requested records, the auditor will calculate an assessment based on available information. Any missing source documents such as sales invoices, payable invoices or exemption certificates will be assessed.

The following procedures should be used when requesting financial records from the taxpayer:

- Prepare informal requests (email/letter) and formal request for financial records (RFR) for necessary, specific, and complete information.
- Ensure that all relevant information is requested at the same time (e.g., sales invoices and corresponding exemption certificates).
- Provide clarifying explanation of why certain records are being requested when necessary.

Request for Financial Records (RFR) Steps:

1. Prepare an informal request for records following initial taxpayer contact.

- a. Records requested for audits scheduled within 120 days of the expiration of the statute, out-of-state audits, or audits where the taxpayer postpones the start of fieldwork beyond 30 days of the initial contact must be requested on a formal RFR; refer to step 2.
2. Records necessary to complete the audit that are not made available during fieldwork or records requested under Step 1a must be requested on the RFR.
 - a. Ask the representative to sign the RFR acknowledging receipt of the request.
 - b. If the representative declines to sign indicate: “*The taxpayer declined to sign*” and the date when the RFR was provided at the bottom of the form.
 - i. Use email tracking to document receipt of RFRs not delivered in person.
3. Grant 30 days for RFRs.
 - a. Exceptions, only at the taxpayer’s request, are given.
 - i. Discuss the request with supervisor.
 - ii. Taxpayer must provide written request for periods greater than 30 days.
 - iii. The request must identify the date records will be provided.
 - iv. If the taxpayer request less than 30 days, use this date on the RFR.
4. Schedule an appointment to review the records with the representative for the due date of the RFR.
 - a. For out-of-state audits, the auditor must contact the taxpayer prior to the booking of the trip to confirm the availability of the requested records.
5. Create a calendar appointment for the due date of the RFR and send a copy to supervisor with a copy of the RFR.
6. The due date of the RFR **must** be entered in the “Audit” tab, “Attributes” subtab in PATH.
7. Contact the representative a week prior to the due date of the RFR to check on the status of the requested information.
 - a. Record date and result of call.
8. Ensure that the taxpayer completed the RFR **and** indicates why certain records were not made available or request an extension of time.
9. If the taxpayer doesn’t provide requested records or request an extension, issue a second RFR and a cover letter which can be found in the Bureau’s audit application software.
 - a. Consult with supervisor prior to issuing second RFR.
 - b. Follow steps 2-8 above.
 - c. Inform the taxpayer of the potential deficiency.
 - d. Send a copy to the representative’s immediate supervisor.
10. If the taxpayer doesn’t provide requested records or requests another extension, issue a third and “Final Request” and a cover letter which can be found in the Bureau’s audit application software.

- a. Auditor must consult supervisor prior to issuing third and final RFR.
- b. Follow step 2-8 above.
- c. The audit report and schedules showing the audit deficiency will be prepared and included with the “Final Request”.
- d. A copy must be sent to the representative’s immediate supervisor and a corporate officer.

Note: A second or third RFR is not required for requesting specific source documents such as exemption certificates, purchase orders, specific sales invoices, and specific purchase invoices. However, it is recommended to request the source documents when requesting records necessary to identify detail transactions. For example, when requesting the fixed asset schedule, the corresponding purchase invoices should also be requested. Any second or third RFR for specific source documents must be approved by the supervisor.

Requesting Records from Third Party

The confidentiality provisions of the Sales and Use Tax Act require approval in those instances where an auditor contacts the supplier or customer of a taxpayer under audit for information.

The auditor should request that the taxpayer secure all necessary documentation to conduct the audit. A *Request for Financial Records* form should be presented to the taxpayer for all necessary records not made available.

When the taxpayer does not have records in their possession, they may obtain documentation from third parties.

The auditor may not contact a third party for documentation unless express written consent has been obtained from the taxpayer. See sample letter: [Requesting Records from Third Party Sample Letter](#) .

The only exception to the requirement to obtain written permission from the taxpayer is when third party contact is necessary in establishing fraud. Should the reason for contacting a supplier be to establish fraud, the auditor must obtain approval from the Director of the Bureau of Audits. All facts surrounding the audit must be explained in the request. Approval will then be sought from the Office of Chief Counsel in order to protect the auditor from the charge of violating confidentiality.

Penalty Abatement

The auditor may offer penalty abatement only if the following criteria is met:

1. All collected tax is remitted (*i.e., there is not state or local sales tax deficiency*). Cash to accrual conversion on a first-time audit are accepted only if:
 - a. All of the tax collected on the cash basis was properly reported or
 - b. The adjustments to the accrual account are to correct jurisdiction issues (*i.e., the result is not net accrual deficiency and a deficiency in one jurisdiction is exactly offset by a credit in another*).

2. The total audit assessment is less than \$15,000 or less than 25% of the total combined reported tax.

If both criteria are met, the taxpayer qualifies for discretionary penalty abatement at the audit level.

Penalty abatement is approved by the audit supervisor who will sign the [Penalty Abatement Approval Form](#) prior to providing the [Penalty Abatement Petition Form to the taxpayer](#). Both forms are to be included on the *Additional Headquarters Processing Request* form indicating penalty abatement is being offered.

Supervisors may contact the Program Administrator to receive approval to either deny or offer penalty abatement if the taxpayer does or does not qualify for penalty abatement on the above criteria. The reason for exception approval should be listed in the “Additional Comments” section of the approval form and approval from the Program Administrator must be obtained prior to providing any petition forms to the taxpayer.

Note: The auditor should instruct any taxpayer that are not offered penalty abatement at the audit level that they can still petition for reassessment to have their penalties abated.

Research & Development-Testing Laboratories

The auditor must use the following methods to determine whether a testing laboratory qualifies for the manufacturing/research exemption:

- Determine areas that are not directly used in manufacturing:
- Managerial activities
- Sales activities
- Other nonoperational activities of a research establishment or project, motor vehicles, & etc.
- The test laboratory may concede certain labs/division as not qualifying for an exemption under the Lancaster Labs court decision.
- Labs that only test water samples or perform nutritional label testing may be excluded.
- The taxpayer under audit must survey customers to determine whether the testing being done for clients qualifies for the manufacturing/research exemption or provide other documentation to establish the activities performed for their customers qualify for the exemption.

Sample Questions:

Describe your company's general business operations and the specific business activities that were relevant to your transactions with (taxpayer's name).

For the listed invoices, please describe the services that were provided by (taxpayer's name) and the specific segment(s) of your business to which the services relate. If samples were

submitted for analysis, please describe the nature of the submitted samples and from where in your business process the samples were generated.

Describe the primary objectives of the services that were provided by (taxpayer's name).

The taxpayer must be able to provide total revenue per customer and based on determination for each customer, calculate revenue generated from activities that meet the threshold of manufacturing in Lancaster Laboratories and or qualify as contract research. "*Exempt Customer Revenue*"/Total Revenue = %. If the survey for the department/division indicates the equipment is used more than 50% of the time in an exempt manner, then 100% of the purchase price of the equipment is exempt from tax. Supplies will be assessed based on the taxable percentage of the department/division.

Example:

If the surveys determine the property is used 70% of the time in an exempt manner, then 30% of the supplies used in the department/division will be subject to tax.

If the taxpayer refuses to do the survey, this will be documented in the audit narrative and should be formally documented by a [Request for Financial Records](#) form or other evidence that the request was made, and the taxpayer refused. All assets and expenses will be assessed. This procedure has been sustained through BOA and BF&R.

Services-Employee Cost

The Bureau will allow the purchaser to obtain amended invoices or statements from the vendors establishing the amount of nontaxable employee costs when such costs were not listed on the original invoice. This policy will apply to only the purchaser of Help Supply, Employment Agency and/or Interior Office Cleaning services. The amended invoices or statements may be used for assessment purposes, issuing a third-party credit or overpayment of use tax.

The statements from the vendors must be on the vendor letterhead and signed by the vendor or authorized representative. The statements are to include the period of time of the transactions and the percentage of employee costs on each individual invoice or the aggregate percentage of employee costs.

Note: Templates are available in the "Forms and Packages" folder in the Bureau's audit application software to calculate employee costs.

Taxable Use of Equipment Purchased for Resale, Rental or Charter

When a taxpayer purchases equipment (such as a crane) or other items exempt from tax by claiming resale, rental or charter, the taxpayer is responsible for self-assessing use tax on the fair rental value of the item that is put to taxable use. Fair rental value will be considered to be the prevailing market rate (by hour, day, or month). If the rental usually includes an operator, the cost of the operator may be subtracted from the prevailing market rate to arrive at the fair rental value. Operators supplied by anyone other than the owner of the equipment should be treated as help supply.

The auditor should document the determination of the fair rental amount established by use of supporting documentation such as rate schedules or price lists.

Note: The tax applicable to the fair rental value of items purchased for resale, rental, or charter should not be confused with items that are determined to be exempt from tax due to predominance of use.

Consent/Waivers

The *Consent to Extend Time Limit for Assessment/Determination of Tax and to Extend Period of Time for Record Retention* form is used to extend the time limit for record retention and assessment of the specific tax under audit. When collateral audits are performed on different types of taxes, a separate waiver is needed for each type of tax.

In order to protect the Commonwealth's interest where reporting periods are in jeopardy due to the expiration of the statute of limitations, waivers will be required under the following circumstances:

Mandatory and Priority Assignment

Audits identified by the Program Administrator as mandatory or as a high priority in the case management system must be completed without the loss of any statutory periods.

Sales Tax Assignment in Inventory

All sales tax assignments in the regions inventory by **September 1** must be completed without the loss of any statutory periods. Audits received after that date but before **November 1** are to be reviewed by the Regional Manager for potential non-compliance to ascertain if an attempt to schedule fieldwork and pursue a waiver is warranted.

Issuing a Waiver and Waiver Extensions

Taxpayers Delays

When scheduling is delayed at the taxpayer's request or the taxpayer is not providing records that allow for the timely completion of the audit before statutory periods expire, a waiver must be obtained.

Note: Once waiver extensions exceed eighteen months from the original statutory deadline, regions are required to bring audit periods forward before authorizing additional waivers or request the follow-up collateral audit.

Audit Plans

Waivers and extensions of waivers are required to be accompanied by an Audit Plan that is reviewed internally with the Regional Manager and established with the taxpayer's representative.

Exception can be made by the Regional Manager for situations where the taxpayer is requesting a delay start of the audit and the waivers is for a period of time less than 18 months from the original statutory deadline.

Periods to Expire within Three Months

A waiver is not to be requested from a taxpayer for any period that will expire within three months of the engagement letter date unless it is a collateral assignment or there is Program Administrator approval.

Waiver Extensions

Any waiver extending the original statutory deadline beyond eighteen months is only to be granted with:

- a taxpayer commitment to an audit timeline in writing, or
- a taxpayer signed Audit plan.

Any exceptions must be approved by the Program Administrator.

Monitoring Waivers

The audit supervisors are to monitor each audit in progress on which a waiver has been obtained to make sure that the auditor begins and completes the audit timely and allows sufficient time for the audit assessment to be mailed before the period expires. As part of this monitoring process, the beginning and ending dates of the waived period as well as the waiver expiration date must be entered into PATH as soon as possible.

The revenue regional manager is ultimately responsible for obtaining the waiver and the timely completion of the assignment.

When properly completed, the waiver becomes a binding legal document.

The waiver must be signed by a corporate officer, an authorized POA or a principal member of the legal entity.

An auditor may accept an electronically signed waiver or an electronic image of wet signature waiver if the signer provides corroboration that the use of their electronic signature was authorized. To corroborate the signature, the Regional Manager should send an email to the signer's email address requesting the signer to verify they did authorize the use of their signature.

Note: The above waiver policy does not pertain to trust fund money taxes collected and not reported. Taxes collected and not reported may be assessed for any period beyond the statute.

Suggested email content:

Subject: *Digital Signature Verification – Consent to Extend Time Limit to Assess – SLSAXXXXX*

Mr./Mrs. XXXXX,

A “Consent to Extend Time Limit for Assessment/Determination of Tax and to Extend Period of Time for Record Retention” was recently received by the Bureau of Audits extending the period for assessment for “Name Legal Entity”.

This form included your signature in an electronic format that is not directly verifiable by the Bureau of Audits.

Please respond to this email confirming you authorized the use of your electronic signature on this form.

Figure 8.4 Suggest email content for waiver.

If the recipient of the email indicates they did not authorize the use of their signature or fails to respond to the email, the waiver cannot be accepted. If the recipient authorized the use of their signature, a copy of the response should be included as an attachment to the waiver.

For any electronic image of wet signature, an attempt should be made to obtain a hardcopy of the wet signature.

Note: A waiver is not required for non-filed returns or filed returns when there is evidence of the failure to report collected sales tax.

Board of Appeals (BOA) and Board of Finance & Revenue (BFR) Decisions

For the most part, **Section 210 of the Taxpayer’s Bill of Rights** prevents the Department from assessing a taxpayer that raises an identical or substantially identical issue(s) when the BFR issues a decision in favor of the taxpayer and the Department has not appealed the decision. This includes refund and reassessment petitions.

The Department is not bound to follow a prior BOA or BFR decision under the following circumstances:

- The Department appeals the BFR decision to the Commonwealth Court.
- Decisions from the BOA.
- The Department publishes a bulletin addressing the Department’s position on the specific issue. However, any change will be applied prospectively from the date the bulletin was issued.

- Any change in statute or court decision affecting the specific issue. However, any change resulting from a change of statute will be applied prospectively from the effective date of the statute.
- If the facts or circumstance surrounding a favorable decision change or are not the same as presented to the Boards.

The regional staff must consult with HQ before deciding not to follow any prior BOA or BFR decisions.

Link: [1996 Act 195 - Section 210 of Taxpayer's Bill of Rights](#)

Audit Plan and Audit Status Worksheet

An *Audit Plan* is **required** if a waiver or waiver extension has been requested. As a best practice, the *Audit Status Report Worksheet* should be completed at the start of every audit to assist the auditor to properly organize and manage the audit, so it is performed in an effective manner.

Difference of Audit Status Report Worksheet and Audit plan

Both reports can be found in the **SLSWKS.xlsm** within the attachment folder of the Bureau's audit application software. The *Audit Status Report Worksheet* is to be completed by the auditor to track the progress of an audit and assist in devoting the appropriate attention to important areas of the audit. The worksheet lists the audit area to be reviewed, the method being used to complete the review, the procedures being used, what records are required, expectation to complete, along with several other descriptive columns. The information inputted in the worksheet, which is a macro-enabled Excel file, will carry over to the *Audit Plan*. Once the worksheet is completed and the Audit Plan needs to be generated, the auditor will click the "Refresh Audit Plan" which will create the *Audit Plan* to submit for review and approval.

The *Audit Plan* outlines the audit area that still needs to be reviewed, what procedures will be used, the records required to complete the review. The *Audit Plan* also includes date the taxpayer is to provide records and a target date to complete the review.

Procedures

The *Audit Plan* is required with all waivers and waiver extensions. The *Audit Plan* will be printed, reviewed, and approved with Supervisor. The *Audit Plan* will be attached to the *Consent to Extend Time Limit for Assessment/Determination of Tax and to Extend Period of Time for Record Retention* form and approved by the Regional Manager. Each *Audit Plan* prepared and approved will be saved to the Bureau's audit application software under attachments.

Entity Changes

If the *Bureau of Audits Registration Verification* form discloses a FEIN change or an ownership change occurring as result of the following scenarios listed below, then the entity may require a new account number.

Note: Any change in entity requires a new assignment number.

As a result of a:	Then:
Sole proprietorship to another sole proprietorship regardless of if husband and wife.	The successor sole proprietor is considered a new entity. The new entity must obtain a new account by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Sole proprietorship to a corporation	The corporation is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Sole proprietorship to a partnership (Whether or not the sole proprietor is one of the partners.)	The partnership is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Partnership to a sole proprietorship regardless of if a partnership still exists.	The sole proprietor is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Partnership adds or subtracts a partner and receives a new EIN.	The partnership is considered a new entity since it received a new employer identification number. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Partnership to a corporation	The new corporation is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Corporation to a corporation	The new corporation is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Corporation to a limited liability company (through merger or stock sale)	A new audit assignment number is necessary for the new LLC even if the LLC has retained the same EIN as the corporation. LLC must obtain a new account number by completing an application online via "Pennsylvania

	Online Business Tax Registration" in myPATH .
Corporation to a sole proprietorship	The sole proprietorship is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Corporation to a partnership	The partnership is considered a new entity. The new entity must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .
Sole Proprietorship to Single Member LLC	A new audit assignment number is necessary for the new LLC even if the LLC retain the same EIN as the sole proprietorship. LLC must obtain a new account number by completing an application online via "Pennsylvania Online Business Tax Registration" in myPATH .

Figure 8.3 Entity Changes Examples

Refund of Sales Tax Paid – (REV-1890)

The rental of equipment is subject to tax. In situations where the taxpayer is requesting a third party credit claiming the rental was a nontaxable service, the vendor and the taxpayer must complete the [Vendor Acknowledgement of Sales Tax Incorrectly Charged and Agreement to Pay Sales and Use Tax, \(REV-1890\)](#). This form acknowledges the vendor incorrectly charged sales tax on a nontaxable service. As part of the acknowledgement, the vendor agrees to remit appropriate tax on the taxable personal property used in providing the nontaxable service, including any tax on the fair rental value of the equipment. Additionally, the vendor agrees to extend the time limit for assessment of any tax. If the vendor fails to remit the appropriate tax, the Department will assess such tax against the vendor, plus appropriate interest, and penalties. This form must be included as part of the audit report.

Also notify HQ on the *Additional Headquarters Processing Request* form of the REV-1890.