



Dealing With Audits and Other Revenue Department Contacts in Pennsylvania

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Dealing With Audits and Other Revenue Department Contacts

A. Common Audit Issues, Including Sampling, Exemption Documentation, etc.

1. Appeals Challenging Audit Methodology

Standard for Appeal. 61 Pa. Code § 8a.10 provides that a "taxpayer may appeal the accuracy of a test audit by providing clear and convincing evidence that the method used for selecting a statistical sample or block sample test period and determining the tax liability is erroneous, lacks a rational basis or produces a different result when the complete records are considered." See 72 P.S. § 10003.21(c).

Common Errors in Audit Methodology. In some cases, the actual methodology used by an auditor may not conform to the Department's regulations or may be improper for other reasons:

- *Inclusion of Outliers in Test Sample* - Sometimes, an auditor will mistakenly include statistical outliers (discussed above) in a test sample and project them over the entire audit period. Issues sometimes arise as to the proper manner for computing a statistical outlier.
- *Unrepresentative Sample* - Where a company conducts several types of operations, it may be inappropriate to apply a margin of error developed primarily as a result of reporting errors related to one line of business against sales arising from other lines of business. Issues concerning the representativeness of a sample may also arise where there has been a major change in a taxpayer's operations, such as the implementation of a new computer system or a corporate reorganization.
- *Isolated Transactions* – It may be appropriate to request that transactions of a type which do not occur on a regular basis be removed from a test sample. For example, it may be improper to project a test period deficiency resulting from an executive placement fee over the entire audit period if that transaction represents the only placement service purchased during the audit period.
- *Sample Size* - A test sample may be challenged on the basis that the size of the sample is too small to produce reliable audit results. For example, the review of a taxpayer's records for a one-week period may be insufficient to reliably estimate its tax liability for a three-year audit period.
- *Small Number of Transactions* - In some cases, test audit methodology may be challenged based on the development of a substantial deficiency from a small number of assessed transactions. It is possible for a large deficiency to result from a small number of assessed transactions even if none of the specific transactions constitutes a statistical outlier.
- *De Minimis Error Rate* - Under certain circumstances, an audit deficiency may be stricken because it is based on an error rate which is less than .005.

In appropriate cases, it is advisable to raise the argument that a deficiency is based on a *de minimis* error rate even if the error rate exceeds .005.

2. Exemption Certificates

General Rule

Every person who is required to collect tax must, in every case in which tax is not collected, have available for Departmental inspection a valid, properly executed exemption certificate which was accepted in good faith or, in lieu of such certificate, the following:

- Evidence that the property sold or rented is not tangible personal property or a taxable service.
- Documentary evidence that the customer is the United States or an instrumentality thereof, the Commonwealth, or a political subdivision or instrumentality of the Commonwealth.
- Documentary evidence that the property was delivered to a destination outside the Commonwealth.

61 Pa. Code § 32.2(a).

No exemption certificate is required if the tangible personal property is of a type which is never subject to tax or where the sale is in interstate commerce.

Good Faith Acceptance

A seller or lessor who accepts in good faith an exemption certificate which discloses a proper basis for exemption upon its face is relieved of any liability for tax on transactions covered by the certificate. *Id.* at § 32.2(b).

In order for a certificate to disclose a proper basis for exemption it must meet the following requirements:

- The certificate must be an officially promulgated exemption certificate form, or a substantial and proper reproduction thereof.
- The certificate must be dated and executed in accordance with the instructions and must be complete and regular in every respect.
- The certificate must state a proper exemption reason.

Id.

An exemption certificate to be accepted in good faith must also comply with the following:

- The certificate must contain no statement or entry which the seller or lessor knows, or has reason to know, is false or misleading. A certificate accepted by a seller or lessor, in the ordinary course of business, which on its face discloses a valid basis of exemption consistent with the activity of the purchaser and character of the property or service being purchased, is presumed to be taken in good faith. *Id.* at § 32.2(b)(2).
- A seller or lessor is presumed to be familiar with the law and regulations regarding the property he sells. Where a seller has accepted a blanket exemption certificate, each transaction between the parties is considered a separate claim for exemption, and the seller must exercise good faith in each transaction. *Id.*
- The certificate must be in the physical possession of the seller or lessor, and available for Departmental inspection, on or before the 60th day following the date of the sale or lease. Where a certificate is not made available on or before that time, the seller or lessor must prove, by means of evidence other than an exemption certificate, that the sale or lease in question is, in fact, exempt. *Id.*

Penalties. False or fraudulent statements made on an exemption certificate by any person is a misdemeanor. *Id.* at § 32.2(c).

Forms of Certificates

- General use.** The Department has published forms entitled Sales and Use Tax Exemption Certificate, which may be used as follows:
 - Unit exemption – single sales or leases of tangible personal property.
 - Blanket exemption – claims of exemption upon sales and leases of tangible personal property in a series of transactions between parties.

Id. at § 32.2(d).

- Motor vehicles.** A special form is designed for purchase of motor vehicles, and is not valid for other purposes. This form is used for claims of exemption upon the purchase or lease of a motor vehicle, trailer, semi-trailer or tractor which is required by law to be registered with the Bureau of Motor Vehicles, and must accompany the application for title. *Id.*

B. When to Seek Intervention of Higher Authority

C. Obtaining Formal and Informal Guidance on Issues of Concern

1. Private Letter Rulings

The Department issues private letter rulings to taxpayers upon written request, based on specific factual information provided to the Department. The purpose of a private letter ruling is to advise a taxpayer concerning application of the tax laws to a specific factual situation unique to the taxpayer. *See* 61 Pa. Code § 3.3(a). Therefore, private letter rulings issued by the Department's Office of Chief Counsel may be relied upon only by the particular taxpayer who requested the ruling, based upon the facts supplied to the Department. *Id.* at §3.3(b). Absent a change in the law or rescission by the Department, a taxpayer may rely on a private letter ruling for 5 years from the date of issuance, at which time the taxpayer can renew the ruling by resubmitting it to the Office of Chief Counsel for review. *Id.*

The Department has discretionary authority as to whether to issue a private letter ruling in response to a taxpayer's request. 61 Pa. Code § 3.3(c). Examples of situations where private letter rulings normally will not be issued include (1) issues under extensive study or review by the Department, (2) alternative plans of proposed transactions or hypothetical situations, (3) matters upon which a lower court decision adverse to the Department has been issued, the appeal period is still open, and the question of following the decision or litigating the matter further has not been resolved, and (4) transactions, the purpose of which is to avoid taxes. *Id.*

