

CHAPTER 8a. ENFORCEMENT

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Authority

The provisions of this Chapter 8a issued under sections 270 and 2910-A of the Tax Reform of 1971 (72 P. S. §§ 7270 and 9910-A), unless otherwise noted.

Source

The provisions of this Chapter 8a adopted March 27, 1998, effective March 28, 1998, 28 Pa.B. 1522, unless otherwise noted.

§ 8a.1. Definitions.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise.

Audit period—The period of time for which the audit is conducted.

Block sample—One or more groups of transactions selected as a unit from a population. For example, invoices numbered 100 to 200, or transactions for the months of May and October.

Clustered sample—A statistical sample in which blocks of adjacent transactions are selected with known probability. A statistical sample of transactions within the blocks may be selected, creating a two-stage statistical sample.

Deviation from the mean—The numerical difference between a single statistical observation and the mean (average) of all of the statistical observations.

Outlier—A statistical observation that appears to deviate markedly from other members of the sample from which it came.

Population—The total transactions during an audit period from which the sample is selected.

Range—The numerical difference between the largest and smallest statistical observations in the sample.

Standard deviation—The square root of the average squared deviation from the mean.

Standard error—The standard deviation divided by the square root of the number of statistical observations in the sample.

Statistical estimation—A method of estimating the numerical characteristics of a population, such as averages, totals or ratios, from a statistical sample and estimating the precision of the estimated characteristics.

Statistical sample—A selection of transactions in which each of the transactions in the population, or a stratum from it, has a known chance of being selected. The term is also known as a probability sample.

Stratum—A subdivision of the population in which the transactions within the subdivision are expected to be more uniform with respect to the characteristics being examined than the transactions across the subdivisions.

Taxpayer—A person, association, fiduciary, partnership, corporation or other entity required to pay, withhold or collect any tax that is administered by the Department.

Test audit—An audit of sampled transactions selected by either a block sample or a statistical sample method.

Test period—A time period or periods selected for the test audit; for example, the month of May.

Transaction—The term includes an entry, document, invoice or other record regardless of the method of creation or retention.

§ 8a.2. Examination of books and records.

The Department may examine all books, papers and records of a taxpayer or another person having possession of or dominion over these records to:

- (1) Verify the accuracy and completeness of a tax return or tax report filed by the taxpayer and ascertain or assess tax or other liability owed to the Commonwealth.
- (2) Ascertain or assess tax or other liability owed to the Commonwealth if no tax return or tax report has been filed by the taxpayer.

§ 8a.3. Audit types.

Examination may be made by desk audit, field audit or another form of audit.

§ 8a.4. Determination of liability.

The Department may determine tax liability owed by a taxpayer to the Commonwealth based upon the facts contained in a tax return, a tax report or other information that may come into the Department's possession.

§ 8a.5. Determination of audit method.

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

- (1) The type of tax under audit.
- (2) The nature of the taxpayer's business.
- (3) The number of transactions in the population.
- (4) The adequacy and availability of the taxpayer's records.
- (5) Whether the taxpayer's business is cyclical or seasonal.
- (6) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
- (7) Other relevant factors.

§ 8a.6. Selection of sample.

When a test audit is employed, the selection of the block sample, statistical sample or clustered sample shall be based on the Department's analysis of the taxpayer's business operations and records, and shall reasonably represent the population from which the sampled transactions were selected. The Department may utilize stratification levels in performing statistical sampling. When a block sample method is chosen, the Department will select blocks whose average is approximately equal to the estimated average of key characteristics for the audit period. Examples of key characteristics include sales, taxable to gross sales ratio, purchases or number of transactions.

(1) In determining whether to exclude the values of certain transactions from the sample, the Department will identify the transactions in the sample that are outliers.

(2) For the purpose of identifying outliers, the Department will determine the transaction difference for each transaction in the sample. The transaction difference shall be the difference between the transaction's audited value and its value reported to the Department. Any transaction difference with an absolute value greater than 2% of the total audited amount of the total sample shall be considered to be a suspected outlier. If the difference is no greater than 2% of the total audited amount of the total sample, no adjustment will be made. If the difference is greater than 2% of the total audited amount of the total sample, the following test will be done: Subtract the average of the transaction differences, omitting the suspected outlier, from the suspected outlier and divide by one-fourth of the range in values of the transaction differences, omitting the suspected outlier. If the absolute value of the ratio is four or greater, the suspected outlier shall be confirmed as an outlier. If there is more than one suspected outlier, this test shall be applied sequentially to all suspected outliers. If the population is stratified this process will be completed for each stratum in which sampling has been done.

(3) The following steps will be taken with respect to all confirmed outliers:

- (i) The taxpayer will be notified concerning the outliers and requested to furnish evidence that will be considered by the auditor in determining the

audited finding. If, upon examining the further evidence, the auditor agrees that a smaller difference between the reported amount and the audited amount is justified, the auditor will replace the original transaction by the adjusted finding.

(ii) If sufficient evidence is not provided, the outlier will be eliminated from the sample and audited independently. The audit finding on the outlier will be computed separately and the audit finding will be added to or, if negative, subtracted from the result of the projection for the remaining sample.

(iii) The sample values, adjusted for outliers as provided in subparagraphs (i) and (ii), will be used for projection of the total audit finding and its standard error.

(4) When determining whether to employ the test audit method in an audit of a tax under 75 Pa.C.S. §§ 9601—9622, (relating to motor carriers road tax) or a similar tax which may be enacted, the Department will consider the following factors:

- (i) The average fleet mileage as reported by the taxpayer.
- (ii) Whether the vehicles are company-owned, permanently leased from owner-operators, or a combination of both.
- (iii) The types of vehicles that make up the fleet.
- (iv) The type of fuel used to power the vehicles.
- (v) The geographical area in which the vehicles operate.
- (vi) The type of commodities being hauled.
- (vii) The total number of vehicles in the taxpayer's fleet.
- (viii) The adequacy and availability of the taxpayer's records.
- (ix) Whether the taxpayer's business is cyclical or seasonal.
- (x) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
- (xi) Other relevant factors.

(5) When employing a test audit method in an audit of a State or local Sales and Use Tax or Hotel Occupancy Tax or Public Transportation Assistance Tax (72 P. S. §§ 7201—7282 and 9301; 53 P. S. §§ 12720.501—12720.509; 16 P. S. §§ 6150-B—6157-B) or a similar tax which may be enacted, the Department will consider the following factors:

- (i) The average gross sales.
- (ii) The ratio of taxable sales to gross sales.
- (iii) Whether the taxpayer's business is cyclical or seasonal.
- (iv) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
- (v) The adequacy and availability of the taxpayer's records.
- (vi) Other relevant factors.

Cross References

This section cited in 61 Pa. Code § 8a.7 (relating to statistical estimation and software).

§ 8a.7. Statistical estimation and software.

The audit results shall be computed by projecting the audit findings identified in the sample, as adjusted for outliers as provided in § 8a.6(3) (relating to selection of sample) to the population, regardless of whether the sample is a statistical sample or a block sample.

(1) When the Department employs the block sampling method, the standard error cannot be estimated.

(2) When the Department employs the statistical estimation method, a standard error of the estimate shall be computed from the sample observations adjusted for outliers as provided in § 8a.6(3) to indicate the reliability of the estimated average, total or ratio. The Department may use software that has been designed in accordance with accepted statistical practices. The formulas utilized by the software will be available for examination by the taxpayer.

(3) Except as otherwise mutually agreed to by the Department and the taxpayer, the number of observations in the sample will be chosen so that the projected sample will, on the average, yield an estimated precision within 25% of the midpoint of a 90% two-sided confidence interval. In determining the size of the sample, the Department will use the sample size selection table in paragraph (4). The estimated precision of the sample selected may be less than or greater than 25%, depending upon the variability in the sample data. The standard error and estimated precision will be calculated and reviewed with the taxpayer. The sample size will be increased upon the request of the taxpayer. The process of increasing the sample size will be repeated until mutual agreement is reached between the taxpayer and the Department on an acceptable number of observations.

(4) The following sample size selection table identifies estimated sample sizes required to produce estimates with specified precision:

Sample Size Selection Table

Precision	Confidence Interval (2 sided)	Estimated Coefficient of Variation (CV)								
		0.25	0.50	0.65	0.75	1.00	1.50	2.00	3.00	5.00
5%	90% Normal	68	271	650	609	1,083	2,435	4,330	9,742	27,060
10%	Deviate	*	68	115	153	271	609	1,082	2,435	6,765
15%	1.645	*	31	51	68	121	271	481	1,082	3,007
20%		*	*	29	39	68	152	271	609	1,691
25%		*	*	*	25	44	97	173	390	1,082

Precision	Confidence Interval (2 sided)	Estimated Coefficient of Variation (CV)								
		*	*	*	*	*				
30%		*	*	*	*	31	68	120	271	752
35%		*	*	*	*	23	50	88	199	552
40%		*	*	*	*	*	38	68	152	423

* Fewer than 20 sample observations are required.

§ 8a.8. Test audit plan.

Prior to conducting a test audit, the Department will set forth in writing a test audit plan and provide the taxpayer with an opportunity to review and comment on the plan. The plan will describe the time period subject to audit, the records subject to review, methods for selecting records, statistical estimation procedures including the taxpayer's right to request an increase in sample size and the manner in which any tax liability will be calculated based upon the records reviewed.

§ 8a.9. Audit findings.

At the conclusion of the audit, the audit findings and a copy of the work papers will be provided to the taxpayer. The auditor will:

- (1) Discuss the findings with the taxpayer.
- (2) Provide the taxpayer the opportunity to comment in writing.
- (3) Explain the procedures for the processing, assessing and appealing of the audit findings.

§ 8a.10. Taxpayer appeal.

The 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.

§ 8a.11. Applicability.

This chapter applies to all taxes administered by the Department.

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