Clearinghouse Rule 18-080

PROPOSED ORDER OF THE DEPARTMENT OF REVENUE CREATING RULE

The Wisconsin Department of Revenue proposes an order to: **create** Tax 11.905 **relating to** sales and use tax provisions.

The scope statement for this rule, SS 129-17, was approved by the Governor on December 15, 2017, published in Register No. 744B on December 26, 2017, and approved by the Secretary of Revenue on January 8, 2018.

Analysis by the Department of Revenue

Statutes interpreted: s. 77.59 (2g), Stats.

Statutory authority: s. 77.59 (2g) and 227.11 (2) (a), Stats.

Explanation of agency authority: Section 77.59 (2g), Stats., provides "[t]he department shall promulgate rules to establish criteria applicable to field audits conducted under this subchapter for which an auditor uses a statistical sampling method…"

Section 227.11 (2) (a), Stats., provides "[e]ach agency may promulgate rules interpreting the provisions of any statute enforced or administered by the agency, if the agency considers it necessary to effectuate the purpose of the statute..."

Estimate of amount of time that state employees will spend developing the rule and of other resources necessary to develop the rule: The department estimates it will take approximately 100 hours to develop the rule.

Related statute or rule: Section 77.59 (2), Stats., provides "The [field audit] determination may be made on the basis of sampling, whether or not the person being audited has complete records of transactions and whether or not the person being audited consents."

Plain language analysis: This rule establishes criteria applicable to field audits for which an auditor uses a statistical sampling method. The rule also provides that any person with less than $10,000,000 in annual sales during any year may choose to have the audit conducted using statistical sampling. Finally, the rule specifies the number of transactions necessary to qualify for statistical sampling and the maximum sample size.

Summary of, and comparison with, existing or proposed federal regulation: There is no existing or proposed federal regulation that is intended to address the activities to be regulated by the rule.

Comparison with rules in adjacent states: The department is not aware of a similar rule in an adjacent state.

Summary of factual data and analytical methodologies: 2017 Wisconsin Act 59 created s. 77.59 (2g), Stats., which provides in part, that the Department of Revenue shall promulgate rules to establish criteria for field audit statistical sampling. The department has created this proposed rule order to reflect this statutory change. Audit

experience and practices, as provided in Department of Revenue Publication 516, *Statistical Sampling,* were used in the preparation of this proposed rule order.

Analysis and supporting documents used to determine effect on small business: This rule order reflects the creation of s. 77.59 (2g), Wis. Stats., which authorizes the Department to provide specific criteria for persons under audit with less than $10,000,000 in annual sales during any year in a field audit may choose to have the audit conducted using statistical sampling. The proposed rule order reflects experience and practices for those persons as provided in Department of Revenue Publication 516, *Statistical Sampling*.

Anticipated costs incurred by private sector: This proposed rule does not have a fiscal effect on the private sector.

Effect on small business: This proposed rule provides specific criteria for businesses under audit with less than $10,000,000 in annual sales in that the business may request that its audit be conducted using the statistical sampling method.

Agency contact person: Please contact Jen Chadwick at (608) 266-8253 or jennifer.chadwick@wisconsin.gov, if you have any questions regarding this proposed rule.

Where to submit comments and submission deadline: Comments may be submitted to the contact person shown below no later than December 3, 2018. Information as to the place, date, and time of the public hearing will be published in the Wisconsin Administrative Register.

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SECTION 1. Tax 11.905 is created to read:

Tax 11.905 Statistical Sample Criteria. (1) PURPOSE. The purpose of this section is to establish criteria applicable to field audits using statistical sampling conducted by the department. Sales transactions and purchase transactions must independently meet the criteria in sub. (4). This section does not apply to non-statistical sampling conducted by the department in field audits.

(2) DEFINITIONS. In this section:

(a) "Annual sales" means net sales reportable for federal income tax purposes for the person's taxable year.

(b) "Electronic records" means machine readable records that include electronic transactions and electronic source documents.

(c) "Electronic transaction" means a record produced by a computerized data processing accounting system that is used for recording an accounting transaction.

(d) "Maximum sample size" means the maximum number of sample units selected using statistical sampling for each sample population identified.

(e) “Net error” means the total error from the sample population determined by projecting the error from each subgroup or stratum of the sample population and summing those results.

(f) "Person" has the meaning in s. 77.51 (10), Stats., and includes an entity described in s. 77.61 (19m) (a), Stats.

(g) "Record" means any document described in s. Tax 11.92 (1).

(h) "Relative precision" is the accuracy of the sample projection compared to the real or inherent value of the net error sampled for in the population.

(i) "Sample population" means the electronic transactions from the total population that will be used to draw the sample. More than one sample population may exist in the total population.

Example: A person uses separate accounting systems to record purchase and sales transactions. The department draws samples from two sample populations; one for purchase transactions and one for sales transactions.

(j) "Sample unit" means a single electronic transaction within the sample population. A sample unit may be a single transaction or separate items of a transaction depending on how the person records the transaction in its data processing accounting system.

Example: For each equipment sales transaction, person enters two transactions in its data processing accounting system; equipment and delivery. Equipment and delivery are each sample units.

(k) "Source document" means a record containing the detail of a transaction entered in a data processing accounting system.

(L) "Statistical sampling" means a sampling method in which the department randomly selects a sample of electronic transactions and uses probability theory to evaluate the sample results.

(m) "Total population" means all of a person's electronic transactions produced by a computerized data processing accounting system.

(3) PROCEDURES. (a) The department may, by field audit, determine the tax required to be paid to the state or the refund due to any person on the basis of sampling, whether or not:

1. The person being audited has complete records of transactions,

2. The method is statistical sampling, or

3. The person being audited consents.

(b) Any person with less than $10,000,000 annual sales during any year at issue in a field audit may require the department to use statistical sampling in that field audit, if all of the criteria in sub. (4) are met.

(c) Upon the department's determination of the sample population, a sample is generated of sample units and source documents for those sample units are made available to the department's auditor.

(d) The department may use more than one sample population to draw sample units for purposes of determining an error rate and tax due or refund. The following are examples of when the department may use a separate sample population and sampling method to select sample units:

1. Significant changes in the person's computerized data processing accounting software.

2. Changes to laws that effect the tax treatment or recordkeeping of a person's sales or purchases.

Example: A new exemption for certain supplies used by the person occurs in the third year of a four-year audit period. The sample units randomly selected for review occur in the first and second year of the audit period, when the exemption did not apply. If the department finds that no tax was paid on the supplies, a projection of the error for the audit period may result in an over-assessment of tax on the supplies.

3. Changes to the person's internal procedures for reporting sales and use tax.

4. Changes to the person's business operations or organizational structure.

Example: The person began selling a new line of products in the audit period.

(4) CRITERIA FOR STATISTICAL SAMPLING. All of the following criteria must be met before statistical sampling may be used on a sample population.

(a) All accounting transactions must be maintained in an electronic format and must be capable of secure electronic transfer to the department, in a form useable by the department.

(b) The data processing accounting system must be capable of producing and transferring to the department an electronic spreadsheet of all accounts for each period under audit, including account number, account description, and year-end and pre-closing balances.

(c) All electronic sales transactions must include the following:

1. Customer name
2. Electronic transaction number that identifies and leads to the source document
3. Electronic transaction date

4. Electronic transaction amount
5. Information necessary to determine where sourced under s. 77.522, Stats.

(d) All electronic purchase transactions must include the following:

1. Vendor name
2. Electronic transaction number that identifies and leads to the source document
3. Electronic transaction date
4. Electronic transaction amount
5. Account number from accounting system or other information that identifies where the purchased item was stored, used or consumed

(e) Documentation used to prepare each sales and use tax return filed with the department to report sales and use tax paid must be available for review by the department, including transaction detail, reports, and work papers.

(f) All sample unit source documents must be available for review by the department.

(g) There are at least 10,000 sample units in the sample population.

(5) MAXIMUM SAMPLE SIZE. (a) Except as provided in par. (b), the maximum number of sample units selected for review for each sample population from which a statistical sample is drawn may not exceed 10 percent of the sample population or 15,000 transactions, whichever is less.

(b) Paragraph (a) does not apply if the relative precision of the sample is greater than 20 percent. In determining an acceptable sample size, the department must consult with the person.

Example: If the relative precision of a sample is 20 percent and the net error is $100,000, there is 90% confidence that the true error of the sample population is between $80,000 and $120,000.

Note: Section Tax 11.905 interprets ss. 77.59 (2) and (2g), Stats.

SECTION 2. EFFECTIVE DATE; GENERAL. This rule shall take effect on the first day of the month following publication in the Wisconsin Administrative Register as provided in s. 227.22 (2) (intro.), Stats.

DEPARTMENT OF REVENUE

Dated: _____ By: _____
Richard G. Chandler
Secretary of Revenue

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