Audit Manual

Chapter 5

Penalties

Business Tax and Fee Division
California Department of
Tax and Fee Administration

This is an advisory publication providing direction to team members administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda. Please contact any California Department of Tax and Fee Administration office if there are concerns regarding any section of this publication.

PENALTIES 0500.00

INTRODUCTION 0501.00

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION (CDTFA) POLICY ON PENALTIES 0501.05

It is the policy of CDTFA to encourage and assist all taxpayers in making an accurate and timely self-declaration of their tax liability. When that is done, there should be no occasion for imposition of penalties for negligence or fraud. CDTFA recognizes the many difficulties that taxpayers may be confronted with in attempting to comply with all requirements of the law. While unduly rigid or exacting requirements are not in the best interest of good tax administration, CDTFA does not condone carelessness or deliberate disregard by taxpayers of their obligations to keep accurate records and prepare proper returns. When justified by the acts or omissions of the taxpayer, penalties should be applied properly and impartially. Whenever there is any doubt as to whether factual conditions warrant a penalty for negligence or fraud, that doubt should be resolved in favor of the taxpayer.

RESPONSIBILITY OF AUDITORS FOR PENALTY RECOMMENDATIONS 0501.15

Negligence and fraud penalties are generally imposed as part of the determinations based upon field audit recommendations. Office Making the Audit auditors and their supervisors are responsible for making proper penalty recommendations based upon factual findings. This requires good judgment, common sense and a thorough understanding of the penalty provisions of the law.

A negligence penalty and a fraud penalty can **never** apply concurrently. The two penalties are mutually exclusive. The same is true of the penalty for negligence and the penalty for failure to file a return. However, a fraud penalty and a 10 percent penalty for failure to file may be imposed on the same liability.

TYPES OF PENALTIES — SALES AND USE TAX ACCOUNTS MANDATORY VS DISCRETIONARY PENALTIES 0501.22

Numerous sections of the Revenue and Taxation Code (RTC) impose penalties. Some penalties are mandatory and are imposed automatically. Other penalties are discretionary and may be assessed by auditors in the conduct of their audits. Whenever circumstances warrant the imposition of either a mandatory or a discretionary penalty, but not **both,** the **mandatory** penalty will apply. For example, the penalty for failure to file a return (mandatory penalty) rather than the negligence penalty (discretionary penalty) will be applied in those cases where either penalty is applicable.

Mandatory Penalties

Nature of Penalty	Rate	RTC Sections
Failure to file a return	10%	6511; 6591
Failure to pay taxes	10%	6565; 6591
Failure to pay prepayment amounts	6%	6476; 6477
Electronic Fund Transfer (EFT) related penalties exclusive of prepayments	10%,	6479.3
Failure to pay prepayments by EFT	6%	6479.3
Amnesty interest penalty	50% **(See Note 1)**	7074
Double amnesty penalty	**(See Note 2)**	7073
Failure to pay prepayment amounts by suppliers and wholesalers of fuel	10% **(See Note 3)**	6480.4

Note 1: This penalty applies only to periods eligible for amnesty and is based on the unpaid tax as of March 31, 2005 (see AM sections 0505.00 — 0505.10 for more information).

Note 2: This penalty applies only to periods eligible for amnesty and is applicable to a Notice of Determination issued after April 1, 2005 (see AM sections 0505.00 — 0505.10 for more information).

Note 3: The rate of penalty is increased to 25 percent if the supplier or wholesaler knowingly or intentionally fails to make a timely remittance of the prepayment amounts.

Discretionary Penalties

Nature of Penalty	Rate	RTC Sections
Negligence or intentional disregard of the law or authorized rules and regulations	10%	6478; 6484
Fraud or intent to evade the law or authorized rules and regulations	25%	6485; 6514
Improper use of a resale certificate for personal gain or to evade the tax	10% or $500, whichever is greater	6072; 6094.5
Failure to remit sales tax reimbursement or use tax collected	40% [e]	6597
Knowingly fails to obtain a valid permit for the purpose of evading the payment of tax	50%	7155
Registration of a vehicle, vessel, or aircraft outside the State of California for the purpose of evading the payment of tax	50%	6485.1; 6514.1
Failure to obtain evidence that the operator of catering truck holds a valid seller's permit	$500 for each failure	6074
Failure of a retail florist to obtain a permit before engaging in or conducting business as a seller	$500 **(Note 4)**	6077

Note 4: Plus any other applicable penalties.

TYPES OF PENALTIES - SPECIAL TAX AND FEE ACCOUNTS 0501.23

Mandatory vs Discretionary Penalties

Numerous sections of the Revenue and Taxation Code (RTC) impose penalties. Some penalties are mandatory and are imposed automatically. Other penalties are discretionary and may be assessed by auditors in the conduct of their audits. Whenever circumstances warrant the imposition of both a mandatory and a discretionary penalty, but the law precludes imposing both penalties, only the mandatory penalty will apply. For example, the penalty for failure to file a return (mandatory penalty) rather than the negligence penalty (discretionary penalty) will be applied in those cases where either penalty is applicable.

The mandatory and discretionary penalties applicable to special taxes and fees accounts are presented in the table below, followed by several specific circumstances where multiple penalties may or may not be assessed in special taxes and fees cases.

Mandatory Penalties

Nature of Penalty	Rate	RTC Sections
Unlicensed person, (Diesel Fuel and Cigarettes and Tobacco Products Taxes)	25% or $500, whichever is greater	60361(a), 30211
Unlicensed person (Diesel Fuel Tax - no tax assessed)	$100 for first violation and increasing by $100 for subsequent violations, up to a maximum penalty of $500	60361(b)
Unlicensed person (Motor Vehicle Fuel [MVF] tax)	25%	7726(b)
Unpermitted vendor or user (Use Fuel Tax)	Fine of $100 each offense, not more than $1,000	9351
Backup tax (MVF and Diesel Fuel Taxes) (**See Note 1)**	25% or $500, whichever is greater	7727(b), 60361.5(b)
Late Pay **(See Note 2)**	10%	7655(a), 8876(a), 12287, 12631, 30281(a), 32252(a), 38451(a), 40101(a), 41095(a), 43155(a), 45153(a), 46154(a), 50112(a), 55042(a), 60207(a)
Failure to pay timely (Cannabis Tax) **(See Note 3)**	50%	34013(f)
Failure to pay timely (IFTA)	10% or $50, whichever is greater	IFTA Regulation 1220.100

Note 1: If more than one of the penalties per RTC section 7727(b) for motor vehicle fuel or RTC section 60361.5 for diesel fuel and a misuse of exemption certificate penalty is otherwise applicable, only the penalty totaling the greatest amount shall be imposed, and the backup tax penalty may be imposed only if the amount of penalty exceeds any other applicable penalty.

Note 2: Late file and late pay penalties are limited to one penalty imposed by the section, whichever is greater.

Note 3: The mandatory 50 percent failure to pay penalty under the Cannabis Tax Law is in addition to the 10 percent failure to pay timely penalty or the 10 percent failure to file penalty under the Fee Collection Procedures Law.

Nature of Penalty	Rate	RTC Sections
Failure to file timely	10%	7655(b), 8876(b), 30281(b), 40101(b), 41095 (b) 43155(b), 45153(b), 46154(b), 50112(b), 55042(b) **(See Note 4)** 60207(b)
Failure to file timely (Alcoholic Beverage Tax) (Timber Yield Tax)	$50 $100	32252(b) 38451(b)
Failure to file timely (IFTA)	10% or $50, whichever is greater	IFTA Agreement R1220.100
Failure to file return determination - no return	10%	7660,8801, 12633, 30221,32291,38421, 40081,41080,46251, 60301
Failure to file return determination - no return (IFTA)	10% or $50, whichever is greater	IFTA Agreement R1200.100
Failure to pay prepayment timely (Insurance Tax and Hazardous Substances Tax)	10%	12258, 43155(a)
Failure to pay prepayment timely (MVF)	6%	7659.5
Failure to make prepayment, but timely return and payment (MVF)	6% of the amount equal to 95% of the tax liability	7659.6
Failure to file prepayment timely (Hazardous Substances Tax)	10%	43155(b)
Failure of Electronic Fund Transfer (EFT) filer to file return timely	10%	7659.9(d), 8760(d), 30190(d), 32260(d), 40067(d), 41060(d), 43170(d), 45160(d), 46160(d), 50112.7(d), 55050(d), 60250(d)
Failure of EFT filer to remit payments (exclusive of prepayments) by EFT	10%	7659.9(e)(l), 8760(e), 12601(c)(l), 30190(e), 32260(e), 40067(e), 41060(e), 43170(e), 45160(e), 46160(e), 50112.7(e), 55050(e), 60250(e)
Failure of EFT filer to make timely payment	10%	7659.9(f), 8760(f), 30190(f),32660(f), 40067(f),41060(f), 43170(f),45160(f), 46160(f), 50112.7(f), 55050(f), 60250(f)
Failure to pay prepayments by EFT (MVF)	6%	7659.9(e)(2)
Failure to pay cigarette stamps and meter register settings	10%	30171
Failure to pay cigarette stamps and meter register settings	10%	30171

Note 4: Fees and taxes collected pursuant to the Fee Collections Procedures Law include the California Electronic Cigarette Excise Tax, California Battery Fee, California Tire Fee, Cannabis Cultivation Tax (ended July 1, 2022), Cannabis Excise Tax, Covered Electronic Waste Recycling Fee, Local Prepaid Mobile Telephony Services Surcharge, Lumber Products Assessment, Manufacturer Battery Fee, Marine Invasive Species Fee, Natural Gas Surcharge, and Water Rights Fee.

TYPES OF PENALTIES - SPECIAL TAX AND FEE ACCOUNTS **(CONT. 2) 0501.23**

Nature of Penalty	Rate	RTC Sections
Failure to file due to fraud or intent to evade	25% in addition to the 10% failure to file penalty at 7660, 8801, 12633,30221,32291, 40081,41080,46251,60301	7662, 8804, 12635, 30224,32291,40084, 41083,46254,60303
Fraud or intent to evade (deficiency determination)	25%	7673, 8780, 30205, 32271,38415,40075, 41074 43201(c), 45201(c), 46201(d), 50113(c), 55061(c), 60313
Failure to file due to negligence or intentional disregard (Alcoholic Beverage Tax)	10% in addition to the 10% failure to file penalty at 32291	32291
Failure to make prepayment due to negligence or intentional disregard, but timely return and payment (MVF)	10% of the amount equal to 95% of the tax liability, instead of 6% at 7659.6	7659.7(a)
Deficiency in prepayment due to negligence or intentional disregard, but timely return and payment (MVF)	10%, instead of 6% at 7659.6	7659.7(b)
Negligence	10%	7672, 8779, 12634, 30204,32271,38414, 40074, 41073, 43201(b), 45201(b), 46201(c), 50113(b), 55061(b), 60312
Misuse of exemption certificate (MVF and Diesel fuel)	25% or $1,000, whichever is greater	7405(b), 60106.3(b), 60503.2(b)
Dyed diesel fuel	The greater of $10 per gallon or $1,000 times the total number of penalties imposed	60105(b)
Inspection Refusal	$1,000 for each refusal	60603(b)

Cannabis Tax

The mandatory failure to pay penalty under the Cannabis Tax Law is 50 percent. This penalty is applied in addition to the 10 percent failure to pay timely penalty or the 10 percent failure to file penalty.

REVIEW AND APPROVAL OF RELIEF REQUESTS, DECLARATION OF TIMELY MAILING AND FILING EXTENSION REQUESTS 0501.25

Relief Requests in General

CDTFA may grant relief from penalties, interest, and/or collection cost recovery fees or grant extensions for filing returns or making payments. CDTFA is empowered to relieve taxpayers of mandatory penalties when it determines that the failure to pay taxes or file a return timely was due to a reasonable cause and circumstances beyond the person's control. Such failure must have occurred notwithstanding the exercise of ordinary care and the absence of willful neglect.

Requests for relief are generally submitted online at the CDTFA website. Team members should encourage taxpayers without internet access to visit a field office or another location with secure internet access to complete the request. However, if these options are not available, team members may print and mail the following forms to the taxpayer or their representative:

- CDTFA-735, *Request for Relief from Penalty, Collection Cost Recovery Fee, and/or Interest*
- CDTFA-135-A, *Declaration of Timely Mailing*
- CDTFA-468, *Request for Extension of Time to File a Tax Return*

In cases where a paper request is received, team members should scan and attach the request on the Account springboard and forward the document(s) to the appropriate Headquarters section, bureau, or branch via interoffice mail. For sales and use tax or lumber fee, requests relating to self-assessed liabilities are processed by the Return Analysis Unit (RAU), and requests relating to CDTFA-assessed liabilities are generally processed by the Petitions Section. For special taxes and fees accounts, requests relating to self-assessed liabilities are processed by the Program and Compliance Bureau (PCB). Requests relating to special taxes and fees CDTFA-assessed liabilities should be forwarded to the Appeals and Data Analysis Branch (ADAB), at adab@cdtfa.ca.gov.

Field office team members have a responsibility to make appropriate recommendations to Headquarters sections, bureaus, or branches processing requests; for example, if they have knowledge that a request is not well-founded. For more information about the processing of penalty relief requests, see the Compliance Policy and Procedures Manual (CPPM) sections 535.010 through 535.017.

PROCEDURES FOR RELIEF OF PENALTY RECONSIDERATION 0501.27

Taxpayers may request reconsideration of denied requests for relief of mandatory penalties. Auditors should be aware of these procedures so they may respond to taxpayers' inquiries appropriately.

When the Business Tax and Fee Division (BTFD) recommends denying a request for relief of penalty, a letter from the appropriate section (for example, RAU, PCB or ADAB) will be sent to the taxpayer. The letter will include a statement explaining the decision to recommend denying relief and will also explain that the relief may be reconsidered if the taxpayer provides new information within 30 days.

Team members should **not** regard the 30–day period for the taxpayer to provide additional information as absolute. As long as the request for reconsideration was received timely, taxpayers may provide additional information at a later time which may still be considered and evaluated by team members.

The letter will also explain that if the taxpayer provides additional information and the request for relief is still recommended for denial by the Headquarters' section, the request for relief will then be reviewed by BTFD's Deputy Director.

If BTFD's Deputy Director agrees with the recommendation to deny the request for relief of penalty, the Deputy Director will send the taxpayer a letter explaining they agree with the recommendation to deny relief. If the taxpayer does not appeal the decision within 30 days of the date of the Director's letter, the decision is final.

If the taxpayer disagrees with the Deputy Director's decision to deny relief, they may appeal it by requesting an appeals conference within 30 days of the date of the Deputy Director's letter. The letter will also explain that a request for an appeals conference may be granted or denied.

The section, bureau, or branch that has the authority to determine if an appeal's conference will be granted is the section that processes the adjustment, if one is warranted (for example, RAU, PCB, ADAB, or Petitions Section). If the request for an appeals conference is granted, it will be forwarded to the Appeals Bureau for scheduling. If the request for an appeals conference is denied, the decision is final. The appropriate section, bureau or branch will notify the taxpayer of the decision.

PENALTIES FOR NEGLIGENCE AND FRAUD 0501.30

These penalties are imposed when there is "negligence or intentional disregard" or "fraud or intent to evade" the law or authorized rules and regulations, and may be asserted only as a part of determinations made by CDTFA. Such penalties may be protested and are subject to cancellation if found to have been asserted in error.

When a "fraud" or "intent to evade" penalty has been imposed (i.e., billed on a Notice of Determination), any relief of such penalty shall be made only by the Deputy Director, BTFD.

LOCAL AND TRANSACTIONS TAXES 0501.35

The penalty provisions of this chapter also apply to Uniform Local Sales and Use Taxes and Transactions (Sales) and Use Taxes. The penalties for negligence and evasion normally will apply to state, local, and district taxes. However, a recommendation for penalty may be applied to only one or two of the three taxes, as appropriate.

TAX RETURNS 0502.00

REPORTING BASIS 0502.10

Sales and use tax returns are due on a calendar quarterly basis unless CDTFA requires or allows the taxpayer to file returns on another reporting basis. A taxpayer cannot retroactively be placed on a reporting basis shorter (e.g., yearly to quarterly) than the taxpayer's current reporting basis and become subject to a penalty for late payment because the due date for paying tax under the new reporting basis has already passed. Similarly, a taxpayer who has incurred a late payment penalty cannot avoid that penalty by being retroactively placed on a longer (e.g., quarterly to yearly) reporting basis. For sales and use tax due dates follow this link: https://www.cdtfa.ca.gov/taxes-and-fees/sales-use-tax-returns-filing-dates.htm

Special taxes and fees returns may be due on a monthly, quarterly, yearly or other basis. For special taxes and fees due dates, follow this link:

http://www.taxes.ca.gov/Other_Taxes_and_Fees/Important_Dates/pstdd.html.

DUE DATES OF RETURNS 0502.15

Due dates for returns filed on the various reporting bases are as follows:

Quarterly Basis

Generally, returns are due on or before the last day of the month following the close of the quarter. Taxpayers who make sales and use tax prepayments must also file the prepayment returns in accordance with RTC section 6472.

Irregular Quarterly Basis

For sales tax accounts that are on a 13–month year accounting cycle and are reporting quarterly over a period of 13 months, returns are due on or before the last day of the month following the close of the authorized reporting period.

For special taxes and fees due dates that report on an irregular basis, see the link above.

Monthly Basis

Generally, sales tax returns for each month are due on or before the last day of the following month.

Yearly Basis

Generally, returns are due on or before the last day of the month following the close of the calendar year reporting basis or fiscal year reporting basis, except when the taxpayer closes out before the end of the year. (See AM section 0502.30.)

When changing an account from a yearly or fiscal year basis to another basis, and the effective date is other than the beginning of the yearly reporting period, the district will furnish the taxpayer with a return to report the expired portion of the year to and including the last day of the quarter which precedes the effective date of the new basis. The tax return for the expired portion of the year is due on or before the last day of the month following the effective date of the new basis.

SALES TAX LIABILITY OF PURCHASERS 0502.20

A purchaser, as provided in RTC section 6421, who becomes liable for payment of sales tax, as if the purchaser was a retailer making a retail sale, has an obligation to file returns and is subject to the failure to file penalty provisions of RTC section 6511, if a return is not timely filed.

RETURN DUE DATE FOR SALES AND USE TAX ACCOUNT CLOSEOUTS 0502.30

Except for taxpayers on an annual reporting basis, when a taxpayer sells a business or stock of goods or discontinues the business, the final return is due on or before the final filing date in the reporting period in which the closeout occurred. For taxpayers on an annual or fiscal year reporting basis, the return is due on or before the last day of the month following the close of the quarterly period in which the business was discontinued.

If the Business discontinues between:	The due date of the final return is:
January – March	April 30
April – June	July 31
July – September	October 31
October – December	January 31

Note: When a special taxes and fees taxpayer sells a business or stock of goods, or discontinues the business, the final return is due in the reporting period during which the closeout occurred. For due dates of special taxes and fees, follow this link:

http://www.taxes.ca.gov/Other_Taxes_and_Fees/Important_Dates/pstdd.html.

EFFECT OF LEGAL HOLIDAYS AND WEEKENDS ON DUE DATES 0502.35

Whenever the due date falls on a Saturday, Sunday, or legal holiday, the filing of returns and the payment of taxes may be made on the following business day without penalty. The following is a list of legal holidays as set forth in the Government Code:

New Year's Day	January 1
Dr. Martin Luther King, Jr. Day	3rd Monday in January
President's Day	3rd Monday in February
Cesar Chavez Day	March 31
Memorial Day	Last Monday in May
Independence Day	July 4
Labor Day	1st Monday in September
Veterans Day	November 11
Thanksgiving Day	4th Thursday in November
Day after Thanksgiving	Friday after Thanksgiving
Christmas Day	December 25

If a listed legal holiday falls on a Sunday, the holiday is observed on the following Monday. If Veterans Day falls on a Saturday, the preceding Friday is observed as a legal holiday.

STATUTORY DATE FALLING ON SATURDAY, SUNDAY OR HOLIDAY 0502.36

Other actions that must be timely, include:

1. Waiving the statute of limitations
2. Filing a petition for redetermination
3. Filing a claim for refund
4. Filing a suit (in a court of competent jurisdiction) for refund
5. Issuing a determination

The first four of these acts are permitted by taxpayers, and the last is a duty imposed on CDTFA. All of the acts are required by statute to be performed within a specified period of time.

When the due date of these acts falls on a Saturday, Sunday or holiday, it will nevertheless be timely if filed on the next business day that is not a legal holiday.

EXTENSIONS FOR FILING AND PAYING RETURNS 0502.40

The various business tax laws (for example, RTC section 6459) provide in part:

"The board for good cause may extend, not to exceed one month, the time for making any return or paying any amount required to be paid under this part. The extension may be granted at any time provided a request therefor is filed with the board within or prior to the period for which the extension may be granted."

Requests for an extension of time should be submitted on the CDTFA website. See CPPM 535.000 for more detailed information about how a taxpayer should submit a request. Some requests may be granted automatically if they meet certain criteria.

When an extension is granted for a specific period, a late penalty will not apply if the tax is paid on or before the last day of the period for which the extension was granted. However, when an extension is granted, interest from the date on which tax would have been due must be paid. In cases in which an extension of time has been granted for making a prepayment, interest applies to the unpaid amount of the required prepayment.

FAILURE TO FILE A RETURN 0503.00

WHEN PENALTY APPLIES 0503.05

Each taxpayer who has an active account under any of the revenue laws administered by CDTFA is required to file returns at regular intervals as prescribed by law and required by CDTFA.

When a taxpayer fails to file a return, RTC section 6511 provides that CDTFA will estimate the amount subject to tax based on the information available. Based on this estimate, CDTFA will compute and determine the amount of tax required to be paid. A 10-percent penalty for failure to file is imposed on that amount.

Note: The penalty only applies to periods in which a return was not filed. For example, if the taxpayer is on a monthly reporting basis and failed to file a return for only one month during a period under audit, a penalty would apply only to the amount of tax required to be paid for that month. For example, if a taxpayer on a monthly basis does not timely file a return and make a payment for May, but instead includes these sales on their June return, the failure to file penalty would apply to the amount of tax required to be paid for May even though the sales were subsequently reported in June.

Under RTC section 6487, for sales and use tax, and RTC sections 7675, 8782, 60315, 32272, 30207, 12432, 38417, 40077, 41076, 43202, and 55062 for special taxes and fees, the determination for failure to file a return must be mailed within eight years after the last day of the calendar month following the reporting period for which the amount is proposed to be determined. For special taxes and fees programs, some returns are due on the 15th or the 25th of the calendar month. For detailed information on due dates for returns for the filing of special taxes and fees accounts, visit the following link:

http://www.taxes.ca.gov/Other_Taxes_and_Fees/Important_Dates/pstdd.html.

For eligible amnesty reporting periods, the determination may be issued within ten years from the due date of the tax. (RTC section 7073(d))

When a taxpayer files a return late, RTC section 6591 imposes a 10-percent penalty for failure to file a return on the amount of taxes due, exclusive of prepayments. For example, a taxpayer filed a late return reporting $50,000 in tax owed and had made prepayments totaling $30,000. The 10-percent penalty imposed under RTC section 6591 would be $2,000 ($50,000 - $30,000 = $20,000 × 10%).

WHAT CONSTITUTES FILING A RETURN OR REPORT 0503.15

A return or report is considered filed when the taxpayer provides in writing:

a. A request that the correspondence be accepted as a return or report, regardless of how brief, indicating that the taxpayer is attempting to file a return or report.
b. The reporting period for which the correspondence (return or report) is filed.
c. The amount of tax or fee due or that no tax or fee is due.

When the taxpayer has shown due diligence in making every effort to submit what the taxpayer believes is a return or report, the correspondence submitted should be accepted as a return or report. Even if the correspondence has no gross sales, transactions, or deductions and shows only the net tax or fee figure, it may be accepted as a return if the information listed in a, b, and c above is provided. If a taxpayer's check indicates the reporting period and the measure of the tax or amount of the fee being paid, it may be processed as a return or report. As a general rule, if tax or fees due can be calculated from the information provided, the correspondence should be processed as a return or report. It is important to always consider the taxpayer's intent.

FORM CDTFA–401–E, NOT A RETURN FOR ALL PURPOSES 0503.20

The filing of Form CDTFA–401–E, *Consumer Use Tax Return,* cannot be regarded as the filing of a return with respect to sales tax liability as a seller, or use tax liability for sales made as a retailer, but only as the filing of a return with respect to use tax liability as a purchaser.

CLOSEOUTS/CEASES WITH SECURITIES 0503.30

Liquid securities (e.g., cash deposit, certificate of deposit, or an insured deposit in a bank or savings and loan institution) are considered to be an advance payment of any tax due on or after the date of closeout. Security will be applied in accordance with the guidelines discussed in the Compliance Policy and Procedures Manual (CPPM) Chapter 4, *Security.*

A negligence, fraud, or intent to evade penalty does not apply to a deficiency that is paid by the application of a liquid security where the due date of the closeout return is on or after the closeout date. This is because there was no amount required to be paid to which the penalty can be added. If the taxpayer is on a monthly basis, the quarter or quarters in which the closing month and the preceding month occur should be segregated in the applicable lead schedule (for example, 12A), in order to clearly show the application of any liquid securities and penalties.

Penalty for failure to file will apply if a taxpayer submits a late return even when security is available. Penalty for failure to file will also apply even when security is available to clear delinquent reporting periods. A note is added on the billing to inform the taxpayer of the type of penalty being applied.

When the security is not sufficient to meet the liability for the closing period, the procedure is as follows:

- When a return was filed and an audit is in process, a penalty may be added for negligence.
- When no return was filed and an audit is in process the penalty for failure to file for the amount of the taxes, exclusive of prepayments, with respect to the period for which a return was required, will be included.

A CRM Note should be made when security is available.

When an audit is not warranted, attempts should be made to secure signed returns for periods for which no returns were filed. When the delinquent return or returns cannot be secured, a Field Billing Order (FBO) will be prepared to cover the estimated liability.

ERRONEOUS REFUNDS OF SECURITY DEPOSITS 0503.35

If a security deposit available on the closeout date is erroneously refunded instead of being applied to a liability, no penalty or interest will be assessed where these charges would have accrued solely because of the erroneous refund. Interest will start to accrue if such liability is unpaid 30 days after the mailing of a notice of determination for repayment of the erroneous refund. In cases where there was no liability at the time the refund was made and a liability later developed, applicable penalty and interest will be added.

NO RETURNS FILED FOR PERIOD PRECEDING CLOSING PERIOD 0503.40

There may be instances where no return was filed for the reporting period immediately preceding the closing period, and where the due date for the preceding period is after the date of closeout (for example, the second quarter 2017, when closeout date was July 13, 2017). If any part of the security deposit is applied to the tax due for such periods, a negligence penalty will not attach to the amount of tax so paid. **The security deposit is considered available on the date of closeout.** Therefore, to the extent that it is so applied, there is no amount required to be paid to the state to which penalty can be added. However, if a taxpayer fails to file a timely return for the preceding period, a failure to file penalty will apply to the amount of taxes, exclusive of prepayments, for the period that the return is required.

TAXPAYERS ON A MONTHLY BASIS 0503.45

In the case of a taxpayer reporting on a monthly basis, where no return was filed for the closing month or the preceding month, the quarter or quarters in which such months occur should be broken down in the applicable lead schedule (for example, 12A) to clearly show the application of security deposits and penalties.

AVAILABILITY OF SECURITY BETWEEN BUSINESS TAXES 0503.50

All or the remainder of the security of a taxpayer's account may be transferred to another account of the same Customer. Information relative to the transfer is contained in the CPPM Chapter 4, *Security*.

MORE THAN ONE LOCATION 0503.55

Sellers engaged in business at more than one location must hold a permit for each location, which means that all locations must be listed under the Sites tab on the Customer springboard.

However, taxpayers who hold seller's permits for permanent places of business, and also conduct operations of a temporary nature, at places such as fairs or carnivals, are not required to hold separate permits for the temporary operations. Such taxpayers should report their sales made at the temporary location with the returns filed under their regular permit numbers. For multiple locations, the temporary locations should be listed on Schedule C when the taxpayer files their return through Online Services. For single location permits, the temporary locations should be listed on Schedule B, when the taxpayer files their return through Online Services. The three-year limitation period applies, and the penalty for failure to file returns does not apply with respect to any unreported sales tax liability incurred at the temporary location during any period for which a person has filed a return for a permanent place of business.

The three-year limitation period applies, and the penalty for failure to file returns does not apply with respect to any unreported sales or use tax liability incurred in any period for which a person has filed a return for **any** location. This is true even though the person may operate at one or more other locations for which a separate seller's permit has not been issued.

Where a taxpayer operating multiple business locations fails to include sales in his or her return relating to business at a particular location for which the seller's permit is held, a penalty for failure to file a return does not apply, but the 10 percent penalty for negligence or the 25 percent penalty for fraud may apply, if circumstances warrant.

FAILURE TO PAY 0504.00

WHEN PENALTY ATTACHES 0504.05

RTC section 6591 and similar special tax and fee sections impose a 10-percent penalty for failure to pay tax timely, as follows:

- For self-declared tax, when not paid on or before the due date of the return or before the expiration of any extension that has been granted.
- For determinations made by CDTFA, when not paid on or before the finality date shown on the Notice of Determination unless a timely petition was filed.
- For redeterminations, when not paid on or before the finality date shown on the Notice of Redetermination.

PETITIONS FOR REDETERMINATION 0504.10

RTC section 6565 and similar special tax and fee sections impose a 10-percent penalty for failure to pay the amount of any determination made by CDTFA on or before the date the determination becomes final (the "finality date"). Generally, a notice of determination becomes final 30 days after the date the notice was mailed or personally served unless a petition for redetermination is filed on or before the finality date. (See AM 0504.20 for Jeopardy Determinations.)

A petition for redetermination is considered timely if it is filed on or before the finality date. Generally, a petition filed through CDTFA's online system is automatically accepted by the system as a timely petition, when it is filed prior to the finality date. Petition requests received outside CDTFA's online system (via mail, email, fax) are evaluated by Petitions Sections (Petitions)/Appeals and Data Analysis Branch (ADAB) team members to determine timeliness (team members will review postmark date, emailed date, etc.). Once a petition is acknowledged as timely and valid, an "Active Appeal Case" indicator is placed on the Customer springboard in the system, which prevents collection action and the 10-percent penalty from being assessed.

If a timely petition is not filed and tax is not paid on or before the finality date, the 10-percent penalty is automatically assessed. Verification Comments in the system should also indicate that a penalty will be, or was, assessed. Additionally, the system sends a Demand Notice and Statement of Account, notifying the taxpayer of the outstanding balance due, including a detail of any new penalties assessed.

PAYMENTS OR PETITIONS MAILED BUT NOT RECEIVED 0504.15

For purposes of determining whether a late payment or late filing penalty is applicable, or a petition is filed timely, a payment or a petition alleged to have been placed in the mail will generally not be treated as received or filed timely unless it is received by CDTFA. Exceptions will be made in those instances where the taxpayer furnishes satisfactory proof that the original payment or petition was mailed timely.

JEOPARDY DETERMINATIONS 0504.20

Jeopardy determinations are immediately due and payable and become final within 10 days after the notice of jeopardy determination was mailed or personally served, unless a petition for redetermination is filed and security is deposited within such period, in such amount as CDTFA may deem necessary. CDTFA will not recognize a petition in connection with a jeopardy determination unless such security is deposited with CDTFA in one or more of the following forms:

- Cash deposits, including cashier check and money order (personal checks not acceptable).
- Certificates of deposit issued by banks.
- Savings and loan certificates.

A document that intends to be a petition for redetermination filed in connection with a jeopardy determination where security is not deposited is not a valid petition. If the amount specified is not paid within 10 days after the service date of the notice of jeopardy determination, and without a valid and timely petition, a 10-percent penalty for failure to pay is imposed pursuant to RTC section 6591 and similar special tax and fee sections. A person against whom a jeopardy determination is made may nonetheless apply for an administrative hearing, as provided by Appeals Regulation 35028.

PREPAYMENTS 0504.25

RTC section 6476 and section 7659.5 imposes a 6-percent penalty and sections 43155 and 12258 provide a 10-percent penalty on the amount of a prepayment that is paid late, but which is paid before the last day of the monthly period following the quarterly period in which the prepayment was due.

RTC sections 6477 imposes a penalty when a taxpayer fails to make a prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due, but files a timely return and payment for the quarterly period in which the prepayment became due. The penalty is 6 percent of the amount equal to 90 percent of the tax liability for each of the periods during that quarterly period for which a required prepayment was not made.

The 6-percent prepayment penalty imposed under RTC sections 6477 and 7659.6 is increased to 10 percent if the failure to make the prepayment was due to negligence or intentional disregard.

Prepayment penalties are not assessed in audits. For examples on the application of prepayment penalties, including situations in which multiple penalties can or cannot be assessed, see examples in the tables provided in sections 0501.22 and 0501.23.

ELECTRONIC FUND TRANSFER RELATED PENALTIES 0504.30

The penalties imposed in RTC sections 6479.3 and 6591, and similar special tax and fee sections, apply to taxpayers who are required to pay taxes by means of Electronic Fund Transfer (EFT) and fail to do so. These penalties are limited to a maximum of 10 percent of the amount of taxes, exclusive of prepayments, for the reporting period. Failure to pay prepayments by electronic funds transfer is subject to a penalty of 6 percent of the prepayment amount incorrectly remitted.

For examples for the application of electronic fund transfer related penalties, including situations in which multiple penalties can or cannot be assessed, see examples in the tables provided under sections 0501.22 and 0501.23.

AMNESTY PENALTIES 0505.00

Beginning April 1, 2005, amnesty penalties may be applied to tax liabilities for reporting periods that began prior to January 1, 2003. See AM section 0206.52 for audit comments regarding the Amnesty Program.

50 PERCENT INTEREST PENALTY 0505.05

A. Application
The penalty is imposed pursuant to RTC section 7074 and applies to taxpayers who meet any of the following criteria:

- Qualified for amnesty but did not participate.
- Participated in amnesty but underreported their tax liabilities.
- Applied for amnesty but did not enter into an Installment Payment Agreement (IPA) or pay their tax liability by May 31, 2005.

The penalty does **not** apply to:

- Tax liabilities for eligible tax reporting periods that were included in an IPA in place on January 31, 2005.
- Tax liabilities included in an amnesty IPA, even if the taxpayer subsequently defaults on its agreement.
- Tax liabilities for reporting periods not eligible for amnesty, for example, reporting periods for which a criminal court proceeding had been initiated against the taxpayer prior to amnesty.
- Eligible tax reporting periods where the tax portion of the liability was paid in full on or prior to March 31, 2005 (non-participant) or May 31, 2005 (participant).

B. Computation
The penalty is equal to 50 percent of the interest on the unpaid tax amount remaining due as of March 31, 2005 (non-participants), or May 31, 2005 (participants who did not fulfill all program requirements), computed from the day following the original due date of the tax through March 31, 2005.

The penalty applies to both self-assessed and CDTFA-assessed sale and use tax liabilities and is imposed beginning April 1, 2005 (non-participants) or June 1, 2005 (participants who did not fulfill all program requirements). Regarding CDTFA-assessed liabilities, the penalty is imposed at the time the liability becomes final. Payment of the deficiency prior to the finality date does not prevent the penalty from applying.

DOUBLE PENALTIES 0505.10

In addition to the 50-percent interest penalty, underreporters and nonreporters are subject to a penalty that doubles the rate of all penalties (except the 50 percent interest penalty) applicable to a Notice of Determination issued on or after April 1, 2005 (RTC section 7073). Additionally, if the finality penalty is imposed, it will be applied at double the normal rate.

NEGLIGENCE PENALTIES — GENERAL 0506.00

LEGAL BASIS 0506.05

The RTC sections relating to the negligence penalty contain language like the following:

"If any part of the deficiency for which a deficiency determination is made, is due to negligence or intentional disregard of this part or authorized rules and regulations adopted under this part, a penalty of 10 percent of the amount of the determination shall be added thereto."

DEFINITION 0506.10

Negligence may be defined in general as a failure to exercise due care. In most cases, the law has defined the exercise of due care as such care that a reasonable and prudent person would exercise under similar circumstances. With respect to business tax matters, negligence may be further defined as a substantial breach by the taxpayer of some duty imposed by the law or authorized rules and regulations.

NEGLIGENCE VS. INTENTIONAL DISREGARD 0506.15

There is a technical distinction between negligence and intentional disregard of the law or authorized rules and regulations in that intentional disregard implies something more than negligence. However, intentional disregard is less than fraud or intent to evade the tax and is covered by the "negligence penalty." Accordingly, the term "negligence penalty" will be used to include the penalty for negligence or for intentional disregard. If, however, a situation is encountered where the auditor believes there is strong evidence of intentional disregard of the law or authorized rules and regulations, the audit report should include appropriate comments regarding the evidence of intentional disregard.

Auditors should not assume that a large audit deficiency or overpayment is indicative of either negligence or intentional disregard. Auditors must use their highest skill and best judgment to determine whether the amount of tax has been reported correctly. This same skill and judgment should be used to determine whether a penalty should or should not be recommended. Refer to AM section 0101.20, *Tax Audit Policies*. Auditors must support a negligence penalty with appropriate comments (refer to AM section 0206.35).

ACTS OF AN AGENT, EMPLOYEE OR PARTNER 0506.20

In general, where an agent, employee, or partner of the taxpayer is guilty of negligence, with a resulting tax deficiency, the 10-percent penalty will apply. This is true even though the agent, employee, or partner acted without the taxpayer's knowledge or consent, or acted contrary to the express instructions of the taxpayer. Situations may be encountered where the taxpayer has been defrauded by an agent, employee, or partner and, as a result, did not benefit from the understatement of tax. Whether the negligence penalty is imposed will depend upon whether circumstances made it difficult or impossible for the taxpayer to detect such fraud. The application of a negligence penalty in these instances should be decided on a case-by-case basis.

CONDITIONS UNDER WHICH PENALTY APPLIES 0506.25

The negligence penalty applies only to deficiency determinations and it applies to the total amount of the tax liability. Generally, this means that, if the penalty applies, it will apply for the entire period of the audit regardless of the class of transactions involved. Before the penalty is imposed, the following conditions must be present:

- A tax deficiency, and
- Evidence that any part of the tax deficiency is the result of negligence or intentional disregard of the law or authorized rules and regulations.

PENALTIES APPLICABLE TO ONLY PART OF THE AUDIT PERIOD 0506.30

Situations may be encountered where the condition warranting the imposition of a negligence penalty is not present during the entire period under audit and where the imposition of the penalty to the entire amount of the tax liability would be inequitable. For example, a complete change of management occurred and conditions under one management were entirely different from those under the other. In this type of situation, the auditor will select the appropriate penalty for the appropriate period(s) only. The system allows auditors to select some periods of an audit for penalty application. The Verification Comments in the system must include a full statement of the facts involved.

When considering the recommendation to impose a negligence penalty on a partial audit period, auditors should determine if the taxpayer made any effort during a subsequent period in the audit to correct the situation which led to negligence. If such an effort was made, a penalty may not be appropriate.

PENALTY COMMENTS ON AUDIT REPORTS OR FIELD BILLING ORDERS 0506.35

A comment should be made on any area which will be of value in connection with making a determination or with making decisions regarding future audits (see AM section 0206.01). Penalty recommendations are frequently a source of disagreement between team members and taxpayers. To ensure that both team members and taxpayers understand why a negligence penalty was or was not recommended, a penalty comment using the following guidelines **must** be made in the Verification Comments on the Audit springboard in the system. The **sole** exception is when the tax liability is less than $2,500 **and** no penalty is recommended.

The factors which constitute negligence in keeping records (AM section 0507.00), negligence in preparing returns (AM section 0508.00), and evasion penalties (AM section 0509.00), must be carefully considered before determining whether a negligence or evasion penalty should be imposed. If a negligence penalty is being recommended, the auditor must provide in clear and concise terms the rationale for imposing a penalty. An explanation of the evidence and facts upon which the auditor relies to support the recommendation for imposition of a penalty must be given. The explanation must enable supervisors, reviewers, the taxpayer and/or taxpayer's representative to determine whether the recommendation is consistent with the facts established by the audit. The comments must be factual, not merely the auditor's opinion, and must not be stated in a manner derogatory to the taxpayer or the taxpayer's employees. All penalty comments must be sufficiently clear to provide information that may be useful in subsequent audits of the taxpayer.

If auditors believe the imposition of a penalty is inappropriate, they must use the same penalty comment guidelines as when recommending a negligence penalty. That is, the comments must be clear and concise to enable supervisors and other readers of the audit working papers to determine whether the recommendation is consistent with the facts established in the audit, and to provide information that may be useful in a subsequent audit. "Canned comments" such as "Negligence not noted;" "No negligence noted;" or "No penalty recommended," do not provide enough information and are not acceptable. See AM 0206.00 for examples.

If an evasion (fraud) penalty is being recommended, the Verification Comments in the system **must** include the comment, "Penalty pursuant to RTC section 6485 [or applicable special tax or fee section] is recommended." In addition, a memorandum and an Audit Evasion (fraud) Memo case are required from the Administrator to the Deputy Director, Field Operations Division (FOD), or Deputy Director, Business Tax and Fee Division (BTFD), as appropriate. (see AM section 0509.40 for contents of this memorandum).

To promote consistency in the application of penalties and the writing of penalty comments, all comments must be reviewed by the auditor's supervisor. In addition, special procedures will be used for the following reviews:

- Audit tax deficiency over $25,000 — Reviewed and approved by the auditor's supervisor.
- Audit tax deficiency over $50,000 — Reviewed and approved by the Office Making Audit (OMA), Supervising Tax Auditor III or Business Tax Administrator III, after the review and approval by the auditor's supervisor.

A Supervising Tax Auditor III or Business Tax Administrator III will be deemed to have reviewed and approved the penalty comments when they indicate their approval of the audit as a whole, by staging the audit to Audit Review in the system.

NEGLIGENCE PENALTIES IN A TAXPAYER'S FIRST AUDIT 0506.40

Auditors are frequently faced with the decision of whether to recommend a penalty on the first audit of a taxpayer. This decision must be based on an objective evaluation of the audit findings and the taxpayer's background and experience. Generally, a penalty should not be recommended on a taxpayer's first audit. However, there are circumstances where a penalty would be appropriate. (See Regulation 1703(c)(3)(A).) If a negligence penalty is recommended on the first audit, the Verification Comment in the system "Taxpayer's first audit" should be made in conjunction with a detailed explanation for the penalty recommendation. Criteria that should be considered, among others, are the taxpayer's prior business experience, the nature and state of the records provided, and whether the taxpayer used an outside accountant or bookkeeper to compile and maintain the records, and/or to prepare the returns or reports.

Circumstances in which a negligence penalty may be appropriate in a first-time audit include, but are not limited to, the following:

- The business is controlled by a person or persons that control (or controlled) a substantially similar business that was previously subject to audit. In that earlier audit, team members documented audit issues which resulted in the understatement of taxable sales. These same issues are present in the current audit and resulted in a substantial understatement of taxable sales. (For purposes of this and the following circumstances, "controlled" or "control" means any person having control or supervision of, or who is charged with the responsibility for, the filing of returns or the payment of tax or who has a duty to act for the entity in complying with any provision of the applicable Revenue and Taxation Code section.); or
- The business received written advice from CDTFA regarding a record keeping or reporting issue. In the current audit, the advice received was clearly disregarded, leading to a substantial understatement of taxable sales/transactions. (For purposes of this and the following circumstance, "written advice" does not include publications provided to a taxpayer upon registration for a permit or account.); or
- The business is controlled by a person or persons that control (or controlled) a similar business which received written advice from CDTFA regarding a record keeping or reporting issue. In the current audit that advice was clearly disregarded, leading to a substantial understatement of tax or fee; or

- The owner of the business has a history of opening and closing businesses. The owner opens a business, runs it for a year or two, closes it, and then opens a similar business. The owner subsequently closes the new business before any audit is performed, and then opens another, similar business, with the pattern continuing over many years. No audit was ever performed on any of the prior businesses, in part because the businesses closed before an audit was assigned and performed. The current audit reveals substantial underreporting which appears to be intentional, but the evidence is not sufficient to meet the clear and convincing evidence standard required to impose a fraud penalty; or
- The business has no records of any kind or extremely poor records, which resulted in substantial underreporting. The evidence indicates that it is more likely than not that the lack of records is intentional and is intended to conceal the underreporting; however, the evidence is not sufficient to meet the clear and convincing evidence standard required to impose a fraud penalty; or

The business is controlled by a CPA or former CPA who has prior experience advising businesses of the same type on compliance with the sales and use tax and special tax and fee laws. The audit results in a substantial liability despite the controlling person's extensive experience advising clients of the same type of business on record keeping and in preparing tax and fee returns and reports. For examples of comments with no negligence penalty applied on a taxpayer's first audit, see AM Section 0206.35.

The following examples illustrate when a negligence penalty may apply in a taxpayer's first audit.

Example 1:

Shep Bartlett owned and operated a restaurant serving breakfast, lunch, and dinner, as well as beer and wine. During an audit of the restaurant, Mr. Bartlett provided CDTFA team members with monthly sales summaries but had not maintained any source documentation, such as, purchase invoices, sales receipts, or cash register z-tapes. CDTFA team members determined taxable sales were understated. In the audit working papers, it was documented that Mr. Bartlett had been advised that he was required to maintain source documents and provide them upon audit. Subsequently, Mr. Bartlett formed a corporation, Bartlett, Inc., with himself as the president and sole shareholder. Bartlett, Inc. opened another restaurant which Mr. Bartlett managed. During the first audit of Bartlett Inc., CDTFA team members found that it did not maintain any source documentation such as purchase invoices, sales receipts, or cash register z-tapes, as Mr. Bartlett was previously informed and, upon the current examination of the records, calculated a substantial understatement of taxable sales. Because the same audit issue was documented in the earlier audit of Mr. Bartlett's other restaurant, and documentation showed that CDTFA team members had advised Mr. Bartlett regarding proper record keeping, and because Mr. Bartlett managed the operation of both restaurants, CDTFA team members recommended that the 10-percent negligence penalty be added to the audit determination.

Example 2:

Tony Leo owned and operated a retail store selling antiques to customers both within and outside of California. Mr. Leo wrote to CDTFA requesting advice regarding what documentation was necessary to support sales in interstate commerce. CDTFA team members provided him a written response stating that the sales where the property was to be delivered (to the customer in California) were subject to sales tax. Sales where documentation showed that the property, pursuant to the contract of sale, was required to be shipped and, was shipped, to a location outside California by common carrier, were not subject to tax. During the first audit of the antique store, CDTFA team members discovered that Mr. Leo was claiming as exempt sales in interstate commerce, sales whereby the property was delivered to the customer in California. Because Mr. Leo had previously received written advice addressed to him, on this issue and was reporting sales contrary to the specific written advice, from CDTFA, team members recommended that the 10-percent negligence penalty be added to the audit determination.

Note: The recommendation to impose a 10-percent negligence penalty would also apply in the first audit of a business which is controlled by a person or persons that control (or controlled) a similar business which received written advice from CDTFA regarding record keeping or reporting.

Example 3:

Ace's Automobiles is a seller of used vehicles. It was opened and originally operated under a seller's permit taken out by Charlotte Dealer. After two years, the business was closed and Ms. Dealer opened King's Automobiles, also selling used vehicles. Ms. Dealer closed King's Automobiles after two years and opened Jack's Automobiles, again selling used vehicles. Ms. Dealer managed all three businesses. Based on an audit lead, team members commenced an audit of Jack's Automobiles, after it had been in business only two years. This was the first audit of any of Ms. Dealer's businesses. Audit team members found that many of the Reports of Sale were missing and the records they did obtain appeared to have been prepared just for the audit and indicated unrealistically low selling prices based on the make and model of the vehicles sold. As a result, team members estimated that taxable sales were substantially understated.

Although this was Ms. Dealer's first audit, because Ms. Dealer had been operating used vehicle lots for many years, and her past business practices indicated a conscious effort to avoid being audited, team members recommended that the 10-percent negligence penalty be added to the audit determination.

Example 4:

Kurt Vaughn owned and operated a company in the business of selling musical instruments. Mr. Vaughn did not report any taxable sales, claiming that all property was shipped out of state, via common carrier, pursuant to the sales contracts. During the first audit of the business, Mr. Vaughn provided annual sales summaries but did not maintain purchase invoices, sales contracts or receipts, shipping invoices, bills of lading, or any other source documentation. Furthermore, records obtained from the common carriers indicated that very few sales were shipped out of state, while a substantial number of shipments were to locations in California. The audit resulted in substantially underreported taxable sales but CDTFA team members concluded that there was insufficient evidence to impose a penalty for fraud. However, given the significant understatement of taxable sales, the records from common carriers, and the complete lack of source documentation, team members recommended that the 10-percent negligence penalty be added to the audit determination.

Example 5

Mr. Smith is a Certified Public Accountant (CPA) whose practice, for the last three years, has involved advising and assisting business owners, including numerous restaurants, regarding best practices in running their businesses, record keeping, and assisting them in preparing sales and use tax returns. Mr. Smith decided to close his CPA practice and open a sushi restaurant. In the first audit of Mr. Smith's restaurant, team members found that Mr. Smith had failed to keep complete purchase invoices, had no guest checks or z-tapes, and did not keep records showing any cold food sold "to go." However, Mr. Smith reported 30 percent of his sales as exempt sales of cold food "to go." The audit resulted in a substantial liability involving both unreported total sales and unsupported claimed exempt sales of cold food "to go." Although this was Mr. Smith's first audit, audit team members included the 10-percent negligence penalty because of Mr. Smith's extensive experience with the record keeping and reporting requirements for restaurants.

CLASSES OF NEGLIGENCE 0506.45

A taxpayer may be negligent in a number of ways, but there are only two kinds of negligence which will result in a tax or fee deficiency and which may warrant the imposition of the negligence penalty. These are:

- Negligence in keeping records (AM sections 0507.00 — 0507.50), and
- Negligence in preparing returns (AM sections 0508.00 — 0508.50).

NEGLIGENCE IN KEEPING RECORDS 0507.00

GENERAL 0507.05

Guidelines for the maintenance of records are provided by Regulations 1698, *Records,* 4901, *Records,* and similar special tax and fee regulations. In general, these regulations provide that taxpayers must maintain and make available for examination, on request by CDTFA, or its authorized representative, all records necessary to determine the correct tax liability under the laws administered by CDTFA. Such records include, but are not limited to:

- Normal books of account ordinarily maintained by the average prudent business person engaged in the activity in question.
- Bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account.
- Schedules or working papers used in connection with the preparation of tax returns.

Complete absence of records will constitute strong evidence of negligence. However, auditors should determine if there are mitigating circumstances for the lack of records (see AM section 0507.50). Where records are maintained and a tax deficiency results, various factors must be taken into consideration in determining whether the tax deficiency was due to negligence in keeping records. The term "records" as used herein includes not only those specifically mentioned in Regulations 1698 and 4901, but also such supporting data as resale certificates, shipping documents in support of interstate or foreign commerce transactions, etc.

TEST FOR NEGLIGENCE IN KEEPING RECORDS 0507.10

The primary test for negligence is whether a taxpayer keeps the type of records ordinarily maintained by a reasonable and prudent businessperson with a business of similar kind and size. If the evidence indicates that a taxpayer failed to keep such records and, as a result, failed to compile tax or fee returns or reports with a reasonable degree of accuracy, and cannot substantiate the reported amounts when audited, negligence is indicated, and the 10-percent penalty may be appropriate.

RECORDS NEED ONLY BE ADEQUATE FOR TAX PURPOSES 0507.15

Records need only be adequate for sales and use or special tax and fee purposes. The fact that the records may not be adequate for the purpose of preparing balance sheets or profit and loss statements, or for furnishing accurate cost data, information to stockholders, creditors, or others interested in the business does not necessarily constitute negligence for sales and use or special tax and fee purposes.

RECORDS NEED ONLY BE ADEQUATE FOR TYPE OF BUSINESS 0507.20

Records need only be adequate to meet the tax or fee requirements of the type of business involved. For example, a small restaurant may require a very simple set of records for sales and use tax purposes, whereas, a large department store, oil company, automobile dealer, or contractor, will require a much more complex accounting system.

NEGLIGENCE OF OTHER TAXPAYERS — NO EXCUSE 0507.25

A taxpayer should not be relieved of penalty for negligence in keeping records merely because there are many other taxpayers engaged in the same kind of business who are also negligent in keeping records. Each individual case should be decided on its own merits.

EFFECT OF LACK OF KNOWLEDGE ON PART OF TAXPAYER 0507.30

A taxpayer should not be relieved of a penalty for negligence in keeping records merely because the taxpayer is unaware of the requirements of the law. However, while a lack of knowledge is no defense to the negligence penalty, a taxpayer of little education should not be expected to keep records in as good a form as a taxpayer who has wide knowledge of correct accounting principles. The taxpayer cannot be regarded as negligent merely because the records are kept in a foreign language.

ERRORS IN KEEPING RECORDS 0507.35

Where records are adequate for tax or fee purposes, but with numerous errors that result in the understatement of tax or fee, the test for negligence is whether or not the taxpayer exercised due care in keeping the records.

ERRORS DO NOT NECESSARILY CONSTITUTE NEGLIGENCE 0507.40

No matter how carefully records are prepared and checked, some errors may occur. Accordingly, where errors are made in keeping records, the relative frequency and importance of such errors must be considered before a taxpayer is regarded as negligent. Due consideration should be given to any particular accounting difficulties which are inherent in the taxpayer's business.

CONSIDERATIONS IN CLASSIFYING ERRORS 0507.45

To determine whether errors constitute negligence, the following should be considered:

- **The frequency of the errors relative to the volume of transactions.** The number of errors found must be considered in relation to the total number and dollar amount of the same type of transactions in the audit period.
- **The ratio of understatement to reported amounts.** This percentage of error may be used in a variety of ways. For mark-up audits, the most appropriate evaluation is the ratio of understatement to reported taxable measure, particularly when reported taxable sales have been impeached. For audits where taxable measure is based on a percentage of total sales or claimed deductions, the most appropriate evaluation is the measure of understatement to total reported sales or claimed deductions. For both methods, a large ratio of understatement may be indicative of negligence. If the audit measure is derived from a statistical sample, comparison of the error percentage in the prior audit may be appropriate if the same items are being sampled. A substantive increase or comparable error percentage may be indicative of negligence. However, it must be noted that a ratio of understatement is not, in and of itself, proof of negligence. A ratio should be considered in conjunction with other factors to determine whether negligence has occurred.
- **The cause of errors found by audit.** The cause of errors may result from procedural or operational problems unrelated to negligence. For example, significant changes in sales volume from a prior audit may cause errors that result from staffing problems rather than negligence. Similarly, a business with a large volume of small dollar transactions may find it infeasible to hire the level of staff that would result in the total elimination of errors.

If the errors are too frequent in relation to the volume of transactions, or if the errors result in a higher ratio of understatement than would be expected of a reasonable and prudent businessperson engaged in a business of similar kind and size, or if there appears to have been an absence of due care, the 10-percent negligence penalty should apply.

DESTRUCTION OF RECORDS 0507.50

All records pertaining to transactions involving sales or use tax liability must be preserved for a period of not less than four years, unless CDTFA authorizes, in writing, their destruction within a lesser period.

Whether unauthorized destruction of records constitutes negligence depends on the circumstances in each case.

Records Accidentally Destroyed

When the taxpayer has exercised due care in preserving the records, and the records were accidentally destroyed in spite of such care, the taxpayer cannot be said to have been negligent in failing to retain records. In reaching such a conclusion, auditors should be satisfied that the records were actually destroyed and that the destruction was accidental.

Records Intentionally Destroyed

Where records have been intentionally destroyed or destroyed as a result of negligence or lack of due care on the part of the taxpayer, any tax or fee deficiency that is established will be presumed to have been the result of the taxpayer's negligence in destroying the records. The 10-percent negligence penalty will apply unless there is evidence that the deficiency is not the result of the destruction of the records. Please note that intentional destruction of records may be an indication of fraud or intent to evade the payment of tax or fee (AM sections 0509.00 — 0509.45).

NEGLIGENCE IN PREPARING RETURNS 0508.00

DEFICIENCY DUE TO MISUNDERSTANDING 0508.05

Where there is evidence that the tax or fee deficiency resulted from a reasonable misunderstanding by the taxpayer concerning the application of the tax or fee, no penalty will apply. However, where the taxpayer has been advised, as a result of a prior audit or by other means such as a specific letter, or special industry notice, that the unreported items were subject to the tax or fee, it can be indicative of intentional disregard and a penalty may apply. The 10-percent negligence penalty should not apply when there are mitigating circumstances, such as an attempt on the part of the taxpayer to report the items, or changes in the taxpayer's type of business or business operations that affected reporting of the transactions in question.

TEST FOR NEGLIGENCE IN PREPARING RETURNS 0508.10

As in the case of negligence in keeping records, the test for negligence in preparing returns is whether the taxpayer failed to exercise the degree of care exercised by an ordinary, prudent businessperson who is engaged in a business of a similar kind and size, and who, in good faith, has attempted to prepare the returns with a reasonable degree of accuracy.

MECHANICAL ERRORS 0508.15

Mechanical errors in compiling returns do not constitute negligence unless such errors are sufficiently frequent or sufficiently large in amount to meet the test for negligence.

ERRORS IN APPLICATION OF LAW 0508.20

Erroneous application of the law when completing returns does not constitute negligence unless there is evidence that the taxpayer failed to exercise due care in determining whether the transactions in question are subject to tax or fee. The taxpayer may be regarded as having exercised due care if the taxpayer has acted in good faith and has made a reasonably diligent effort to determine how the tax applies to the taxpayer's business. The average taxpayer can only be expected to exercise the amount of diligence due from an ordinary, prudent businessperson.

DUTY TO MAKE INQUIRY 0508.25

Where there is doubt concerning the correct application of the tax or fee, the taxpayer has a duty to make an inquiry. If the taxpayer fails to make an inquiry, the 10-percent negligence penalty may apply. In general, if the taxpayer does make an inquiry and fails to act upon the results of the inquiry, the 10-percent negligence penalty should apply.

EFFECT OF ERRONEOUS INFORMATION 0508.30

A taxpayer who fails to make a timely return or payment resulting from the taxpayer's reasonable reliance on written advice from CDTFA, may be relieved from the payment of tax or fee, interest, and penalty if the taxpayer meets the requirements for relief under RTC section 6596 and similar special tax and fee sections (AM sections 0105.00 — 0105.10). A negligence penalty should not be warranted if the taxpayer provides evidence that they contacted CDTFA to inquire about the proper application/reporting of tax and fee and was misinformed by CDTFA team members. However, the taxpayer remains liable for the applicable tax or fee and interest.

The taxpayer is required to furnish proof that the underreported tax or fee was the result of the taxpayer's reasonable reliance on erroneous information from CDTFA. In addition, the taxpayer should furnish a written statement of their interpretation of the information provided by CDTFA team members.

FAILURE TO REPORT PURCHASES SUBJECT TO USE TAX 0508.35

The same standards determining the application of the negligence penalty to tax deficiencies arising from an understatement of gross receipts or an overstatement of claimed deductions are used to determine the application of the negligence penalty to a tax deficiency arising from failure to report purchases subject to use tax.

MORE THAN ONE LOCATION 0508.40

A taxpayer operating multiple locations, who fails to include on returns, sales relating to a location for which a permit is held, may be presumed to be negligent for all tax due for that location, unless such omissions are infrequent and do not constitute a substantial part of the total deficiency.

OTHER TYPES OF NEGLIGENCE 0508.45

While the situations described in AM sections 0508.35 and 0508.40 are rather obvious cases of negligence in preparing returns, it is not intended that the imposition of the negligence penalty for this reason be so limited, since many other types of situations will be encountered where items have been omitted from returns for no apparent reason except that the taxpayer was negligent.

WORKING PAPERS ARE DESTROYED 0508.50

When auditors find that working papers used by the taxpayer in preparation of the tax or fee returns or reports have been destroyed and the taxpayer is unable to explain substantial deficiencies in reporting, the taxpayer should be given a reasonable opportunity to prepare new working papers or to explain how amounts reported on returns were computed. Failure or inability on the part of the taxpayer to do so will ordinarily constitute evidence of negligence and warrant the imposition of the 10-percent negligence penalty.

EVASION PENALTIES 0509.00

GENERAL 0509.05

In general, penalties for fraud or intent to evade are imposed only in connection with deficiency determinations made by CDTFA. It is important to remember that CDTFA has the burden of supporting the imposition of an evasion penalty.

The Sales and Use Tax Law sections that impose evasion penalties are listed below. See sections 0501.22 and 0501.23 for evasion penalties applicable to special tax and fee laws.

a. **RTC sections 6072 and 6094.5** — misuse of resale certificate to evade tax, for each transaction, 10 percent of the tax due or $500, whichever is greater.

b. **RTC section 6485** — fraud or intent to evade tax, 25 percent of determination.

c. **RTC sections 6485.1 and 6514.1** — registration of a vehicle, vessel, or aircraft outside of this state for the purpose of evading tax, 50 percent of tax due.

d. **RTC section 6514**— fraud or intent to evade tax by failure to file return, 25 percent of tax, in addition to the mandatory RTC section 6511 failure to file penalty of 10 percent.

e. **RTC section 7155** — failure to obtain a valid permit prior to the date on which the first tax return is due, for the purpose of evading tax, 50 percent of tax due before a permit is obtained.

f. **RTC section 6423(c)** - Exemption certificate; Federal excise tax on diesel fuel, for purchases made for personal gain or to evade payment of taxes, a penalty of 10 percent of the tax or five hundred dollars ($500), whichever is greater.

g. **RTC section 6480.9(f)** - Prepayment exemption, diesel fuel resold for agricultural purposes, each certificate issued for personal gain or to evade the payment of taxes, a penalty of one thousand dollars ($1,000).

DEFINITION OF EVASION PENALTIES 0509.10

Fraud may be defined as conduct intended to deprive the state of tax legally due. Intent to evade may be defined as intent to escape the payment of tax through deception or misrepresentation. Although there may be a legal distinction between fraud and intent to evade, the terms will be considered synonymous in this manual.

EVASION VS. NEGLIGENCE PENALTIES 0509.15

Evasion is a step beyond negligence. When negligence penalties are recommended, the facts should indicate that the taxpayer failed to exercise due care in keeping records or preparing returns, or intentionally ignored certain duties or requirements. The **evasion** penalties are to be applied if it can be shown that the taxpayer not only failed to fulfill certain duties, but such failure was **intentional** and for the purpose of **evading** part or all of the true tax liability.

BURDEN OF PROOF 0509.20

As a matter of law, fraud is never presumed but **must** be proven and the burden of proof is on CDTFA. However, the standard of proof is **not** beyond a reasonable doubt, as in a criminal prosecution. (*See Helvering v. Mitchell* (1938) 303 U.S. 391). Instead, the standard of proof in civil tax fraud cases is "clear and convincing evidence" (In re *Renovizor's Inc.* v. *BOE* (9th Cir. 2002) 282 F.3d 1233). "Clear and convincing evidence" requires evidence so clear as to leave no substantial doubt as to the truth of an assertion of fraud. That is, there is a high probability that the assertion of fraud is true.

A taxpayer's intent to evade the tax is the key element to proving fraud. The mere fact that a taxpayer has a substantial tax liability does not, in and of itself, prove intent. Rather the evidence must support intent. For example, a consistent pattern of underreporting may indicate evasion, particularly if there is no other explanation for the understatement. However, additional evidence (e.g., falsified records) must be provided to support intent to evade when the underreporting is random. In all cases where a fraud penalty is recommended, the Administrator must submit evidence of a substantial nature that the taxpayer knowingly committed specific acts with the intention of defrauding the State of tax which was legally due. (See AM section0509.40.)

CONDITIONS WARRANTING AN EVASION PENALTY 0509.25

Before an evasion penalty can be imposed, there must be **clear and convincing** evidence that an existing tax deficiency is the result of a **deliberate intent to evade the payment of tax**. Where there is a substantial deficiency, which cannot be explained satisfactorily as being due to an honest mistake or to negligence and where the only reasonable explanation is a willful attempt to evade the payment of tax, the 25 percent evasion penalty should apply. The size of the deficiency in relation to the tax reported should be considered. The probability that a deficiency is due to intent to evade increases as the ratio of understatement increases, when it cannot otherwise be satisfactorily explained.

EVIDENCE OF EVASION 0509.30

It is very difficult to secure direct evidence that a taxpayer intended to evade a tax liability. In most cases, it is necessary to rely on circumstantial evidence. Certain facts or actions are, by nature, evidence of a deliberate attempt to evade the payment of tax and that an evasion penalty is warranted. Such facts or actions include, but are not limited to:

- Falsified records, especially when more than one set of records is maintained.
- Substantial discrepancies between recorded amounts and reported amounts which cannot be explained.
- Willful disregard of specific advice as to applicability of tax to certain transactions.
- Tax or tax reimbursement properly charged, evidencing knowledge of the requirements of the law, but not reported.
- Transferring accumulated unreported tax from a tax accrual account to another income account.

Under the "clear and convincing" standard, any assertion of intent to evade the tax must be supported by as many of the above indicators as possible. These indicators of evasion must be documented. In addition to the findings of substantial discrepancies and proper charging of tax or tax reimbursement, other evidence of evasion must be included in the audit working papers. Such evidence can include copies of falsified records, CDTFA letters providing specific advice, copies of previous permits and applications, and evidence of improper transfers of unreported tax. A summary of the evidence must be provided in the audit working papers. The summary must reference the schedules providing the evidence of evasion and must provide an explanation of how the evidence supports the recommendation for an evasion penalty.

AMOUNT TO WHICH PENALTY APPLIES 0509.35

The evasion penalties under RTC sections 6485 and 6514, and similar special tax and fee law sections, are imposed if any part of the deficiency is due to fraud or intent to evade. Therefore, the penalty will apply to the **entire** amount for which the deficiency is determined, except in unusual cases. In unusual cases it may be inequitable to apply the penalty to the entire deficiency. For example, a change in management during an audit period may have resulted in the discontinuance of fraudulent practices, or the reverse. In such cases, the system allows for flexibility for the application of a fraud penalty to apply to only a portion of the audit period and not others.

If an evasion penalty is applied to only a portion of the audit period, an evasion penalty memo is still required. It should include not only an explanation of why the evasion penalty was applied to certain portions of the audit period, but it should also address the reason(s) the evasion penalty was not applied to other portions of the audit period. Note that, if a negligence penalty is also applicable to a portion of the audit deficiency, because the system does not allow a fraud penalty and a negligence penalty to be included in the same audit period (audit case), two audit cases must be completed, resulting in two Notices of Determination being sent to the taxpayer. Generally, this will include the original audit case and a new Field Billing Order.

Except for the penalties imposed under RTC sections 6485 and 6514, and similar special tax and fee law sections, evasion penalties should be applied only to the portion of the deficiency which was the result of the act or acts that constituted evasion.

MEMORANDUM FOR APPROVAL OF EVASION PENALTIES 0509.40

When an audit recommends an evasion penalty, a memorandum is required from the Administrator to the Deputy Director, Field Operations Division (FOD), for sales and use tax, and the Chief, Audit and Carrier Bureau (ACB), for special taxes and fees. Upon the approval of the Administrator or someone acting on his or her behalf, and after the completion of the review of the audit, the memorandum is sent electronically to the Deputy Director, FOD or Chief, ACB for approval. The taxpayer **must not** be furnished a copy of the memorandum until the appropriate authority has approved the evasion penalty.

The memorandum must clearly state the evidence which supports the taxpayer's intent to evade the payment of tax and must identify the elements or indicators of fraud applicable to the specific case. Any confidential evidence that is not included in the audit working papers must be attached to the memorandum. The memorandum must explain why the evasion penalty is appropriate versus the negligence penalty, and how the taxpayer benefited from the evasion. It must **not** include lengthy comments or comments that are already part of the audit verification comments. If the quarterly reconciliation of the audited and reported amounts supports the recommendation of the evasion penalty, such information should be summarized and not be shown on a quarterly basis. If an audit includes related accounts, a separate memorandum must be prepared for each account for which the auditor recommends an evasion penalty.

In addition, auditors should consider the following elements when preparing a memorandum recommending an evasion penalty:

The memorandum:

- Should stand alone and include all relevant information for the penalty recommendation. Attach any information, audit schedules, or other documentation (such as letters, emails, or statements) that are referenced in the memorandum.
- Should include the phrase "clear and convincing evidence" when explaining the reason for the evasion penalty recommendation.
- Must specifically describe the evidence team members believe is clear and convincing evidence of the taxpayer's intent to evade the taxes due.
- Should include a discussion of why the evasion penalty instead of the negligence penalty is appropriate.
- Should include tables, reconciliations, charts, etc., that support the evasion penalty recommendation as these may provide good visual guides to the errors and discrepancies.

Use the term "evade" or "intent to evade" rather than fraud, when possible.

Following are suggested headings and examples of relevant information to include in memorandums recommending an evasion penalty. These suggestions are meant to provide guidance and may be used as an instructional tool. Team members may modify the headings and add any additional information, as needed.

Introduction (example of an opening paragraph):

We recommend application of the 25% penalty per RTC section 6485, for Taxpayer, during the period xx/xx/xx to yy/yy/yy. We believe the evidence described below establishes by clear and convincing evidence that the tax deficiency is the result of a deliberate intent to evade the payment of tax.

If multiple penalties are recommended, separately list all penalties and the applicable periods. If the penalties have specific requirements, in addition to clear and convincing evidence of an intent to evade the tax, such as the 40% penalty, the opening paragraph should also address those requirements.

Business Operations

Summarize the business operations, hours of operations, and any other relevant information.

Audit Investigation

Summarize the taxpayer's recording and reporting method, types of books and records provided, the audit methodology, and the results of the audit investigation.

Describe the taxpayer's involvement in the business, for example, if the taxpayer was involved in the day-to-day business operations, placed orders, purchased inventory, paid vendors, recorded transactions, or prepared the sales and use tax returns, etc. Describe the taxpayer's knowledge of the law and/or reporting requirements; such as, the length of time the taxpayer has been in business, prior permits, prior audits (with or without similar errors), letters to and from CDTFA, the system documentation of communications with the taxpayer, questionnaires or statements from the taxpayer or others involved with the business, such as employees, bookkeepers, and accountants, and CDTFA publications or other information previously provided to the taxpayer.

Evidence Supporting Fraud

The memorandum must clearly describe all the evidence from the audit investigation that supports the taxpayer's intent to evade the payment of tax (see AM section 0509.10 for the definition of fraud). The evidence should include any direct evidence of fraud and/or circumstantial evidence that indicates a deliberate attempt to evade the payment of tax. In most cases, it will be necessary to rely primarily on circumstantial evidence to show that the taxpayer's failure to pay was a deliberate attempt to evade the payment of tax. Evidence that may establish the taxpayer's failure to follow the law was done with the intent to evade the tax may include, but is not limited to:

- Falsified records and/or more than one set of records.
- Substantial and pervasive underreporting.
- Failure to pay substantial tax reimbursement collected from customers.
- Improbable or inconsistent explanations for the underreporting.
- Misrepresentations or other efforts to conceal the correct tax liability.
- Use of multiple bank accounts to conceal income.
- Evidence of improper transfers of unreported tax reimbursement.

Any assertion of an intent to evade the tax must be supported by as many of the above indicators as possible. Any indicator of evasion must be documented to the extent possible. Findings of substantial discrepancies and proper charging of tax or tax reimbursement are generally not, in and of themselves, enough to establish an intent to evade. Other evidence of a taxpayers' intent to evade the tax **must** be included in the memorandum.

Intent to evade must generally be established by evidence that the taxpayer knew the taxes at issue were due and the taxpayer's failure to pay was deliberate and for the purpose of evading the tax (as opposed to the only reason being a lack of funds). Evidence that may be used to establish knowledge of the law includes, but is not limited to:

- Taxpayer's length of time in business.
- Taxpayer's prior operation of other, similar businesses.
- Prior audits, letters, or other written advice received from CDTFA.
- Taxpayer's personal involvement in the day-to-day operation of the business, including but not limited to, the preparation of returns.
- Accurate calculation of tax on taxable sales, including charging the correct amount of district taxes.
- Otherwise accurate recordkeeping of sales.
- Accurate reporting of sales on returns filed with other agencies, such as income tax returns.
- Prior statements by the taxpayer or other employees regarding knowledge of the applicable tax laws.
- Evidence of communications with accountants or bookkeepers regarding the correct reporting of taxable sales.

Always ask the taxpayer for an explanation of the errors/discrepancies that led to the recommendation of the evasion penalty and include the taxpayer's explanation in the memorandum. As explained above, an improbable or inconsistent explanation may be evidence of the taxpayer's intent to evade the tax. If the taxpayer has no explanation for the errors, document this in the memorandum, as well.

The memorandum should always include an explanation of how the taxpayer benefited by evading the payment of tax. For example, by not reporting all recorded taxable sales, the taxpayer has benefited monetarily by retaining the tax collected from their customers. Or, by evading the payment of tax, the taxpayer was operating at a competitive advantage over others in the same business.

Include any tables, reconciliation, charts, etc., in the memorandum that support the penalty recommendation. Attach copies of all documents that are referenced in the memorandum. Documentation that may support an evasion penalty include audit schedules, copies of falsified records, prior audit reports, CDTFA letters or other publications providing specific advice, copies of previous permits and applications, evidence of improper transfers of unreported tax, and letters or notes between the taxpayer and its employees or agents.

Summary and Recommendation

Summarize why the evasion penalty is recommended and include a discussion of why the imposition of the evasion penalty is appropriate instead of a negligence penalty.

For example, prior business experience and/or otherwise accurate recordkeeping, combined with substantial, repeated, and unexplained error rates and/or understatements, improbable and/or inconsistent explanations, falsified records, etc., all are evidence of an attempt to evade that is not merely the result of negligence.

The following provides an example of a concluding paragraph:

The taxpayer was aware of the laws regarding the proper reporting of taxable sales as evidenced by its prior business experience, advice received in prior audits, and otherwise accurate recordkeeping of sales, including the correct calculation of tax on taxable sales. Despite this knowledge, the taxpayer had consistent and material underreporting of taxable sales throughout the reporting period. The taxpayer failed to report substantial amounts of tax reimbursement collected on taxable sales. In addition, the taxpayer was personally responsible for the preparation of the sales and use tax returns and provided inconsistent and improbable explanations for the underreporting. The foregoing is evidence that the taxpayer's underreporting cannot reasonably be concluded to have been an act of mere negligence. The foregoing establishes by clear and convincing evidence that taxpayer failed to report the taxes due with the intent to evade tax and therefore the conduct is not merely negligent, but fraudulent.

In those cases where **criminal** tax evasion is suspected and potential prosecution is contemplated, the case should be referred to the Investigations Section through the Deputy Director, Field Operations Division or the Deputy Director, Business Tax and Fee Division. Criminal prosecution comments should be made only on the copy to the appropriate Deputy Director.

STATUTE OF LIMITATIONS FOR EVASION PENALTIES 0509.45

The application of evasion penalties can extend determinations beyond the three or eight-year statute of limitations set forth in RTC section 6487, and similar special tax and fee law sections, or ten-year statute of limitations set forth in RTC section 7073 (d). Therefore, tax can be assessed and penalties imposed for prior periods in which the taxpayer intentionally understated the tax liability. However, proof that the taxpayer intentionally understated the tax liability, within the otherwise applicable statute of limitations (three, eight or ten years), is not by itself sufficient to support an evasion penalty for periods outside the statutory period. Ideally, evasion should not be asserted for periods outside the applicable statutory period (three, eight or ten years), unless records for the expired periods are available, and such records establish an actual tax liability and support the assertion of fraud.

Where evasion was not disclosed in the audits of prior periods but discovered in a subsequent audit, the prior periods will be included in the subsequent audit if the following conditions are met:

- Evasion was present during the periods previously audited, and
- Such evasion was not discovered during the prior audits because information necessary to its detection was concealed from the auditors who made the previous audit(s) or because of some other act(s) or fraud by the taxpayer.

EVASION BY AGENT, PARTNER OR EMPLOYEE 0509.50

Auditors should recommend the RTC section 6485, 25 percent penalty when a taxpayer's agent, partner, or employee has acted with intent to evade tax payment, even though the attempted evasion occurred without the taxpayer's knowledge or consent. This is because the fraud of the agent is imputed to the principal, except when the principal taxpayer is defrauded by the agent or employee. For example, when tax has been understated to cover up money or property stolen from the taxpayer, such an evasion will not be imputed to the taxpayer and the penalty should not apply. Generally, if a taxpayer has not benefited from the intent to evade, the evasion penalty should not apply.

KNOWINGLY OPERATING WITHOUT A PERMIT 0509.55

Sellers engaged in business at more than one location must hold a permit for each location.

RTC section 7155 imposes a 50 percent penalty of the tax due when a person engaged in business in this state as a seller, for the purpose of evading the payment of tax, **knowingly** fails to obtain a seller's permit. This penalty may be assessed when **all** of the following factors are present:

- The taxpayer was engaged in business in this state as a seller.
- The taxpayer did not obtain a permit prior to the date the first tax return was due.
- The taxpayer, while operating without a permit, knew a permit was required.
- The average measure of tax liability during the period in which the taxpayer operated without a permit was more than $1,000 per month.

In addition, the Section 7155 penalty may apply when a person is engaged in business at more than one location but knowingly fails to . hold a valid permit for each location.

MISUSE OF A RESALE CERTIFICATE 0509.60

RTC section 6072 imposes a penalty of 10 percent or $500, whichever is greater, for each transaction when a purchaser, for personal gain or to evade the payment of tax, knowingly issues a resale certificate while the person is not actively engaged in business as a seller. RTC section 6094.5 imposes the same penalty when the purchaser knowingly issues a resale certificate for personal gain or to evade the payment of tax, for the property that the purchaser knows at the time of the purchase will not be resold in the regular course of business. The normal statute periods apply to RTC section 6094.5 penalty – three years for a reporting period for which the taxpayer filed a return and eight years for a reporting period for which the taxpayer did not file a return. The misuse of a resale certificate penalty generally applies in the following situations:

- The purchaser, who does not hold a seller's permit, issues a resale certificate with an erroneous seller's permit number or gives the valid number of a permit held by another person, or
- The purchaser's permit was closed out prior to the date of purchase, or
- The purchase, regardless of amount, is one of a series of purchases which were not intended to be resold by the taxpayer in the regular course of business, or
- The purchaser knowingly issued a resale certificate for personal gain or to evade the payment of the tax. In these cases, the penalty should normally be applied regardless of the amount of the purchase and whether or not the purchase is one of a series of intentional misuses of the purchaser's seller's permit privileges, or
- The purchaser has been advised either through prior audit(s) or other contact with CDTFA team members on the proper use of resale certificates and/or the application of tax to purchases made for their own use.

The penalty generally does not apply in the following situations:

- The dollar amount of the purchase is very small, the purchase does not appear to be one of a series of intentional misuses of the seller's permit privileges by the purchaser, and there is no indication that the purchaser has knowingly issued a resale certificate for personal gain or to evade the payment of the tax, or
- The purchaser has purchased business supplies or similar items and it appears to be due to a misunderstanding of the law rather than an intentional misuse, or
- The item purchased has been reported on the purchaser's sales and use tax return(s).

It is the act of misusing a resale certificate, without regard to the amount, which warrants the imposition of the misuse of a resale certificate penalty. Therefore, the penalty applies in those instances where there is a pattern of intentional misuse by the purchaser, even though the amounts involved may be small. However, if the facts in question do not clearly support a finding that a resale certificate has been misused, then the penalty for misuse of a resale certificate does not apply.

In those instances where a number of small purchases from the same vendor are noted, a single, rather than multiple, penalty of $500 or 10 percent (whichever is greater) generally applies unless the purchaser has been previously advised of the consequences of misusing a resale certificate.

If the misuse involves large amounts with the intent of evading the tax, the 25 percent fraud penalty under RTC section 6485 for intent to evade the tax should be considered, if the evidence exists to support the imposition of the penalty.

Multiple $500 penalties may be warranted in cases where there is an established pattern of misuse of resale certificates for material amounts with multiple vendors.

Exhibit 1 is a sample letter to be issued to a purchaser who is purchasing tangible personal property that is unusual for the type of business in which the purchaser is engaged. If we are not requesting that the purchaser provide support for a specific transaction, we should make our intent clear. As this letter is addressed to purchasers who we suspect may be misusing a resale certificate, the tone must be explanatory.

Exhibit 2 is a sample letter that may be sent to purchasers when we have enough information to impose the misuse of a resale certificate penalty.

Investigations and Audits

Leads regarding suspected misuses of resale certificates are to be treated as priority assignments. Auditors should investigate the purchaser to determine whether a misuse of a resale certificate has occurred. In those instances where the purchaser states that the merchandise was resold, auditors must verify this statement by tracing the sale(s) to the taxpayer's sales invoice(s), sales journals, general ledgers, sales tax returns, and/or other related books and records.

If the taxpayer states, or the auditor's examination discloses, that the merchandise was not resold, the auditor must expand the examination of the purchasers' records to determine whether other misuses have occurred. If misuse of a resale certificate is confirmed, and the person is engaged in business, consideration should also be given to performing an audit of sales activity to ensure that all sales have been properly reported and exemptions properly claimed. Team members should close out/cease accounts when the purchaser is not required to hold a permit.

The Administrator will be responsible for approving recommendations to impose the misuse of a resale certificate penalty and whether or not prosecution should be sought. In every instance where the RTC section 6072 or 6094.5 penalty is recommended, a memorandum signed by the Administrator, addressed to the Deputy Director, FOD or BTFD ACB Chief, as appropriate, (see AM section 0509.40) should be attached in the system. In addition to penalty comments, comments on whether prosecutions are recommended should be made in the Verification Comments on the Audit springboard.

MISUSE OF AN EXEMPTION CERTIFICATE 0509.65

MOTOR VEHICLE FUEL

RTC section 7405(a) provides that any person, including any officer or employee of a corporation, who gives an exemption certificate provided by a buyer of gasoline blendstocks or by a train operator for motor vehicle fuel that they know at the time of purchase is not to be used by them or the corporation in an exempt manner, for the purpose of evading payment of the amount of the tax applicable to the transaction, is guilty of a misdemeanor punishable as provided in RTC section 8405.

RTC section 7405(b) provides that any person, including any officer or employee of a corporation, who gives an exemption certificate for motor vehicle fuel that they know at the time of purchase is not to be used by them or the corporation in an exempt manner, is liable to the state for the amount of tax that would be due if they had not given that certificate. In addition to the tax, the person shall be liable to the state for a penalty of 25 percent of the tax or one thousand dollars ($1,000), whichever is greater, for each certificate issued for personal gain or to evade the payment of taxes.

DIESEL FUEL

RTC section 60106.3(a) provides that any person, including any officer or employee of a corporation, who gives a train operator exemption certificate for diesel fuel that they know at the time of purchase is not to be used by them or the corporation in the manner or for the purpose entitling the exemption for the purpose of evading payment to the supplier of the amount of the tax applicable to the transaction is guilty of a misdemeanor punishable as provided in RTC section 60706 or a felony punishable as provided in RTC section 60707.

RTC section 60106.3(b) provides that any person, including any officer or employee of a corporation, who gives a train operator exemption certificate for diesel fuel that they know at the time of purchase is not to be used by them or the corporation in the manner or for the purpose entitling the exemption is liable to the state for the amount of tax that would be due if they had not given that certificate. In addition to the tax, the person shall be liable to the state for a penalty of 25 percent of the tax or one thousand dollars ($1,000), whichever is greater, for each certificate issued for personal gain or to evade the payment of taxes.

RTC section 60503.2(a) provides that any person, including any officer or employee of a corporation, who gives a section 60503 exemption certificate (Certificate of Farming Use or Certificate of Exempt Bus Operation) for diesel fuel that they know at the time of purchase is not to be used by them or the corporation on a farm for farming purposes or in an exempt bus operation, for the purpose of evading payment to the ultimate vendor of the amount of the tax applicable to the transaction, is guilty of either a misdemeanor punishable as provided in RTC section 60706 or a felony punishable as provided in RTC section 60707.

RTC section 60503.2(b) provides that any person, including any officer or employee of a corporation, who gives an exemption certificate for diesel fuel pursuant to RTC section 60503 that they know at the time of purchase is not to be used by them or the corporation on a farm for farming purposes or in an exempt bus operation, is liable to the state for the amount of tax that would be due if they had not given that certificate. In addition to the tax, the person shall be liable to the state for a penalty of 25 percent of the tax or one thousand dollars ($1,000), whichever is greater, for each certificate issued for personal gain or to evade the payment of taxes.

In addition, RTC section 60707 provides that notwithstanding any other provision, any person who willfully evades or attempts in any manner to evade or defeat the payment of the diesel fuel tax is guilty of a felony when the amount of tax liability aggregates twenty-five thousand dollars ($25,000) or more in any 12-consecutive-month period. Each offense shall be punished by a fine of not less than five thousand dollars ($5,000) and not more than twenty thousand dollars ($20,000), or imprisonment for 16 months, or two, or three years, or both the fine and imprisonment in the discretion of the court.

INVESTIGATIONS AND AUDITS 0509.70

Leads regarding suspected misuses of motor vehicle fuel and diesel fuel certificates are to be treated as **priority** assignments. Auditors should investigate the purchaser to determine whether a misuse of an exemption certificate has occurred.

If the taxpayer states, or the auditor's examination discloses, that the fuel was not used for the exempt purpose for which it was intended, the auditor must expand the examination of the purchasers' records to determine whether additional misuses may have occurred.

The Audit Examination Branch (AEB) Administrator will be responsible for approving recommendations to impose the misuse of an exemption certificate penalty and whether prosecution should be sought. In every instance where a misuse penalty is recommended, a memorandum is required from the Administrator to the Deputy Director, BTFD (with a copy to the Chief, Audit and Carrier Bureau) and should be attached in the system. In addition to the penalty comments, comments as to whether prosecutions are recommended should also be made in the Verification Comments on the Audit springboard.

If the tax liability aggregates $25,000 or more in any 12-consecutive month period, and if the program area believes felony prosecution may be warranted, the case should be forwarded with a fraud cover memo and Form CDTFA-876, *Tax Evasion Referral*, to the Tax Investigations and Inspections Bureau for further review and possible referral to a prosecutor for potential criminal prosecution.

OUT-OF-STATE REGISTRATION OF VEHICLE, VESSEL OR AIRCRAFT 0509.75

RTC sections 6485.1 and 6514.1 impose a 50 percent penalty on a purchaser who registers a vehicle, vessel, or aircraft outside of California (i.e., in another state or foreign country), for the purpose of evading the tax. The standards of proof for this penalty are similar to those for fraud in general.

The penalty under RTC sections 6485.1 and 6514.1 may not be asserted in conjunction with a penalty under RTC section 7155 (failure to obtain a permit) or section 6485 or 6514 (fraud or intent to evade). However, this penalty may be asserted in conjunction with penalties under RTC section 6511 (failure to file) or RTC section 6072 or 6094.5 (misuse of resale certificate).

The penalty will generally be applicable when the purchaser is a California resident who purchased a vehicle, vessel, or aircraft for use in California and is unable to provide evidence for proper registration out-of-state and a valid explanation why the vehicle, vessel, or aircraft was registered out of state.

FAILURE TO REMIT SALES TAX REIMBURSEMENT OR USE TAX (RTC 6597) 0510.00

MEMORANDUM FOR APPROVAL OF SECTION 6597 PENALTY APPLYING THE SECTION 6597 PENALTY 0510.10

RTC section 6597 provides that any person who knowingly collects sales tax reimbursement or use tax and fails to timely remit the tax to CDTFA shall be liable for a penalty of 40 percent of the amount not timely remitted.

NOTE: Pursuant to RTC section 6597, sales tax reimbursement also includes any sales tax that is advertised, held out, or stated to the public or to any customer, directly or indirectly, as being assumed or absorbed by the retailer.

The penalty applies when **all** of the following conditions are met:

- The unremitted tax averages over $1,000 per month for the reporting period,
- The total unremitted tax exceeds five percent of the total amount of tax liability for which tax reimbursement was collected for the period in which the tax was due, and
- The person's failure to timely remit the tax is not due to a reasonable cause or circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect.

For purposes of section 6597, reasonable cause or circumstances beyond the person's control that caused a person's failure to make a timely remittance, includes, but is not limited to:

- A death or serious illness of the person or person's next of kin.
- An emergency as defined in section 8558 of the Government Code.
- A natural disaster or other catastrophe directly affecting the business operations of the person.
- CDTFA failed to send returns or other information to the correct address of record, that caused the person's failure to make a timely remittance.
- The person's failure to make a timely remittance occurred only once over a three-year period, or once during the period in which the person was engaged in business, whichever is shorter.
- The person voluntarily corrected errors in remitting tax that were made in previous reporting periods and remitted payment of the liability owed as a result of those errors **prior** to being contacted by CDTFA about the possible errors or discrepancies.

Accordingly, when the statutory thresholds are met, and the taxpayer does not establish that the failure to timely remit the tax was due to reasonable cause or circumstances beyond the person's control, the penalty shall be applied.

Below is a sample table of both the $1,000 per month and the five percent thresholds being met.

Quarter	Total Sales Tax Collected	Sales Tax Reported	Unremitted Sales Tax Collected	% Unremitted	Monthly
4Q-17	$10,925	$3,224	$7,701	70.49%	$2,567
1Q-18	$10,688	$3,011	$7,677	71.83%	$2,559
2Q-18	$10,805	$3,804	$7,001	64.79%	$2,334
3Q-18	$9,689	$3,643	$6,046	62.40%	$2,015
4Q-18	$9,692	$2,879	$6,813	70.30%	$2,271
1Q-19	$9,585	$2,877	$6,708	69.98%	$2,236
2Q-19	$9,553	$3,390	$6,163	64.51%	$2,054
3Q-19	$9,692	$3,399	$6,293	64.93%	$2,098
4Q-19	$10,926	$3,119	$7,807	71.45%	$2,602
1Q-20	$10,985	$3,289	$7,696	70.06%	$2,565
2Q-20	$11,107	$4,063	$7,044	63.42%	$2,348
3Q-20	$11,229	$3,903	$7,326	65.24%	$2,442

The following examples illustrate whether the section 6597 penalty may be applicable, based on the necessary thresholds being met.

Example 1

During a quarterly reporting period, a taxpayer's total tax collected is $10,000, as determined by an audit investigation. The taxpayer remits $7,500 of the tax collected. The total unremitted tax is $2,500. The average monthly unremitted tax is $833 ($2,500 ÷ 3 months), which does not exceed $1,000 per month. Since the average monthly unremitted tax is less than $1,000 per month, the 40 percent penalty imposed pursuant to section 6597 **does not apply.**

Example 2

During a quarterly reporting period, a taxpayer's total tax collected is $500,000, as determined by an audit investigation. The taxpayer remits $480,000 of the tax collected. The total unremitted tax is $20,000. The average monthly unremitted tax is $6,666 ($20,000 ÷ 3 months), which exceeds

$1,000 per month. However, five percent of the total amount of tax collected in the same quarter in which the tax was due is $25,000 ($500,000 x .05), which is more than the total unremitted tax of $20,000. Since the unremitted tax amount ($20,000) does not exceed 5 percent ($25,000) of total tax reported in the same quarter in which the tax was due, the 40 percent penalty **does not apply**.

Example 3

During a quarterly reporting period, a taxpayer collected $22,000 in tax but remitted only $10,000, as determined by an audit investigation. The total unremitted tax is $12,000. The average monthly unremitted tax is $4,000 ($12,000 ÷ 3 months), which exceeds $1,000 per month, and five percent of the total tax collected in the same quarter in which the tax was due is $1,100 ($22,000 x .05). Since the average monthly unremitted tax ($4,000) exceeds both the $1,000 per month and the five percent of the total tax collected in the same quarter in which the tax was due ($1,100), the 40 percent **penalty may be applied** to the $12,000 liability, unless the failure to remit the tax when due was due to reasonable cause or circumstances beyond the person's control.

The 40-percent penalty applies only when it is established, by a preponderance of evidence, that the taxpayer knowingly collected and failed to remit the tax. Auditors should make every attempt to obtain the records on an actual basis to establish that the taxpayer knowingly collected and failed to remit the tax. When the auditor is unable to apply the 40-percent penalty on an actual basis, they may, under limited circumstances, establish that the taxpayer knowingly collected and failed to remit the tax by the preponderance of evidence (more likely than not) standard. If the auditor is unable to support the application of the 40-percent penalty by a preponderance of evidence, then it should not be assessed.

Situations in which the penalty may be imposed based on the preponderance of evidence standard may include, but are not limited to, the following:

- The taxpayer provides records for all but one quarter. The review of available sales invoices and summaries establishes that tax was collected. The taxpayer indicated that there was no change to the business operations and accounting system during the audit period. The preponderance of evidence shows that tax was likely collected in the quarter in which the records are missing because the invoices examined by the auditor for the other quarters disclose that an amount for tax was collected, and there was no change to the business operations and accounting system in the audit period.
- The taxpayer provides records for years 1 and 3 of the three-year audit period. The sales invoices for these years demonstrate that an amount for tax was collected. For year 2, the taxpayer claimed a tax-included deduction on their federal income tax return. The taxpayer indicated there was no change to the management team in year 2, and the tax returns for year 2 were prepared by the same accountant who prepared the returns for years 1 and 3. The preponderance of evidence shows tax was likely collected in year 2 because the invoices provided for years 1 and 3 disclosed that tax was collected. In addition, there was no change to the business operations or the management team, and the accountant prepared tax returns for all three years of the audit period.

REVIEW FOR POSSIBLE EVASION 0510.12

Although not all audits that warrant a section 6597 penalty are fraud audits, failing to remit tax collected, under circumstances where the section 6597 penalty applies, may be indicative of a taxpayer's intent to evade the tax, for example, it may be indicative of a taxpayer's dishonesty and an intent to evade tax in other reporting areas. Therefore, when an audit discloses unremitted sales tax reimbursement or use tax collected that warrants the 40-percent penalty, auditors should also make a careful review to determine if an intent to evade the tax is evident.

A memorandum for approval of a section 6597 penalty, from the Administrator of the office recommending the imposition of the penalty to the Deputy Director, FOD, or their designee, is required. This memorandum is to ensure that the section 6597 penalty is consistently applied and meets the statutory requirements (i.e., the liability exceeds $1,000 per month, the liability exceeds five percent of the total liability in the same reporting period, and there is no reasonable cause for the underreporting). The Administrator shall prepare a memorandum to the Deputy Director, FOD, when recommending the imposition of the section 6597 penalty. The memorandum shall include the following information:

- A statement, and the basis upon which it is founded, that the taxpayer knowingly collected sales tax reimbursement or use tax, including any supporting documentation, such as specific audit schedules, audit comments, letters, emails, etc.,
- The actual amounts of the unremitted sales tax reimbursement or use tax collected that is assessed in the audit and a comment that these amounts meet the requirements per section 6597. This information shall be included as a table or schedule illustrating the quarterly amounts of the tax collected and reported,
- Any additional information to support the penalty recommendation, and
- The Administrator's evaluation of the taxpayer's explanation for their failure to remit the tax, or if no explanation was provided, a comment stating so.

When seeking approval of the section 6597, 40-percent penalty, auditors may use CDTFA-659, *Recommendation for Section 6597 40-Percent Approval* Form. This form contains fields for all the required information and may be used in lieu of drafting a formal memorandum. Please note, you may not use the CDTFA-659 approval form if failure to remit tax is due to fraud. Instead, the Administrator must prepare a fraud memorandum and also include all relevant elements for recommending the section 6597 penalty as explained above. Until the system function to submit approval recommendations is available, offices making the audit (OMAs) should submit the fraud memorandum or section 6597 penalty approval form via email. As a reminder, do **not** provide a copy of the fraud memorandum or section 6597 penalty approval form to the taxpayer until the Deputy Director, FOD has approved the penalty recommendation.

In cases when only some periods of the audit meet the threshold limits for the 40-percent penalty, team members may apply the section 6597 penalty to periods that meet the thresholds and a negligence penalty for the remaining periods, if appropriate. This must be done in the system, using the "period level" and not the "audit level" functionality.

STATUTE OF LIMITATIONS PERIOD 0510.15

Tax can be assessed and penalties imposed for periods in which fraud is asserted beyond the statute of limitations set forth in RTC sections 6487 or 7073. Ideally, fraud should not be asserted outside applicable statutory periods unless records for the expired periods are available and those records establish an actual tax liability and support the assertion of fraud (see Audit Manual section 0509.20). Since section 6597 is not an evasion penalty, imposition of the penalty will, generally, not extend the statute of limitations periods.

However, in instances where fraud is present and, absent imposition of the larger section 6597 penalty, a fraud penalty would be imposed, then the statute of limitations periods may be extended. That is, audits that include a 40-percent penalty must conform to the three, eight, or ten-year statute of limitations period unless fraud is asserted. Refer AM 0511.10 for procedures when imposing the RTC 6597 penalty when evasion is present.

PROCEDURES TO PROCESS REQUESTS FOR RELIEF OF SECTION 6597 PENALTY 0510.20

General

The Administrator who recommended the imposition of the section 6597 (40 percent) penalty, reviews the relief request and either denies or makes a recommendation to grant the relief. However, when a taxpayer requests relief of the section 6597 (40 percent) penalty on an appealed liability, the request is handled through the normal appeals process.

Relief Requests

Requests for relief of the section 6597 penalty may be submitted online using CDTFA's Online Services, or by written request. The Petitions Section will create a relief case in CROS, if one was not automatically created, and will assign the owner of the case to the Administrator of the office that recommended the imposition of the 6597 (40 percent) penalty. See Compliance Policy and Procedures Manual (CPPM) section 535.055.

Review of Online Relief Requests

The Administrator is responsible for reviewing the relief request within 30 days of the referral and determining if the taxpayer's failure to timely remit sales tax reimbursement or use tax was due to reasonable cause or circumstances beyond the taxpayer's control as provided in RTC section 6597.

Relief Request Denied

When the Administrator recommends denial of the relief request, the Administrator must inform the taxpayer, in writing, of the denial and forward a copy to the Petitions Section mailbox(btfdpetsection@cdtfa.ca.gov). Upon receipt of the letter, the Petitions Section will change the owner of the case to staff to finalize the relief request. No further approval is required for a denial.

Relief Request Granted

When the Administrator recommends relief be granted, the recommendation must be forwarded to the Petitions Section mailbox to obtain approval from the Deputy Director, FOD. The assignment should be reassigned back to the Petitions Section in the system to finalize the online penalty.

DYED DIESEL FUEL PENALTIES 0510.25

RTC section 60105 Dyed Diesel Fuel Penalty Dual Determinations:

RTC section 60105(c) provides that if a business entity is subject to a dyed diesel fuel penalty, each officer, employee, or agent of the entity who participated in any act giving rise to the penalty shall be jointly and severally liable with the entity for the penalty. The auditor should discuss the potential for such dual determination with the audit supervisor.

Memo for approval of RTC section 60105 penalty:

Although RTC section 60105 dyed diesel fuel penalties are not evasion penalties, any related tax assessed due to a dyed diesel fuel penalty is assessed as backup tax and is due immediately along with any penalty and interest due. A memo from the Audit Examination Branch (AEB) recommending the imposition of the penalty to the Deputy Director, BTFD, or designee is required. The memo is to ensure that RTC section 60105 penalty is consistently applied and is imposed on any person who does any of the following:

a. Sells or holds for sale dyed diesel fuel for any use that the person knows or has reason to know is a taxable use of the diesel fuel.
b. Holds for use or uses dyed diesel fuel for a use other than a nontaxable use and that person knew, or had reason to know, that the diesel fuel was so dyed.
c. Knowingly alters, or attempts to alter, the strength or composition of any dye or marker in any dyed diesel fuel.
d. Fails to provide or post the required notice with respect to any dyed diesel fuel. The failure to provide or post the required notice creates a presumption that the person so failing knows the diesel fuel will be used for a taxable use.

The memo recommending the imposition of RTC section 60105 penalty from the AEB Administrator to the Deputy Director, BTFD, with a copy to the Chief, Audit and Carrier Bureau, shall include the following information:

a. A statement, and the basis upon which it is founded, that, as applicable, the taxpayer knowingly or had reason to know, that they violated one or more of the above RTC sections 60105 penalty requirements.
b. The amount of diesel fuel tax assessed in the audit.
c. Any additional information to support the penalty recommendation, and
d. The Administrator's evaluation of the taxpayer's explanation regarding their sale, use, or storage of dyed diesel fuel, or if no explanation was provided, a comment stating so.

Until the function to submit approval recommendations is available in the system, AEB team members should submit the fraud memo or RTC section 60105 penalty approval form via email. As a reminder, do not provide a copy of the fraud memo or RTC section 60105 penalty approval form to the taxpayer until the Deputy Director, BTFD, has approved the penalty recommendation.

Memo for approval of evasion penalties (Fraud Memo)

When fraud is asserted in an audit that includes dyed diesel fuel penalty/penalties, only one memo is required as covered in Audit Manual section 0509.75. A memo that recommends both an evasion penalty and the RTC section 60105 penalty/penalties, in the same determination, should contain separate sections for each penalty recommendation.

MULTIPLE PENALTIES 0511.00

Two or more evasion penalties may not be added to the same deficiency determination when the penalties apply to the same series of acts or course of action in the same reporting periods.

- If a person with intent to evade tax fails to obtain a permit and fails to file a return, either RTC section 7155 penalty (50 percent for failure to obtain a permit) or RTC section 6514 penalty (25 percent for fraud or intent to evade tax by failure to file return) may be imposed, but **not** both.
- RTC section 7155 penalty (50 percent for failure to obtain a permit) may not be applied in conjunction with a section 6485 penalty (25 percent for intent to evade).
- RTC section 6597 penalty (40 percent for knowingly collecting and failing to timely remit tax) may not be applied to liabilities for which a fraud or evasion penalty, or a negligence penalty has already been more appropriately assessed, in the same period.

The system does allow, within the same Audit case, a 6597 penalty and a fraud penalty, in the same audit period, but not on the same quarter/month. However, this can only be done at the "period level" but not at the "audit level" in the system. (See sections 0511.10 – 0511.25 for more information about applying penalties with a 6597 penalty.)

The only two penalties that cannot be applied to the same audit period, in the system, are the fraud (25 percent) and the negligence (10%) penalties. There should not be a need for this except in very unusual circumstances. An example would be when the taxpayer made changes to their reporting practices and the fraud no longer exists, or the reverse. When this occurs, there must be a new Audit case created, one case including the fraud penalty and one case including the negligence penalty. Generally, this will include the original audit case and a new field billing order.

However, under certain circumstances, more than one penalty may apply to the same determination:

- RTC section 6511 penalty (10 percent for failure to file return) should be applied along with RTC section 6514 penalty (25 percent for fraud or intent to evade tax). RTC section 6511 penalty (10 percent for failure to file return) may be applied with RTC section 7155 penalty (50 percent for failure to obtain a permit) when appropriate.
- RTC section 6511 penalty (10 percent for failure to file a return) may be applied in conjunction with RTC section 6597 penalty (40 percent for knowingly collecting and failing to timely remit tax).

The series of acts or course of action involved in the misuse of a resale certificate for the purpose of evading payment of tax on purchases are different from those involved in failing to obtain a permit for the purpose of evading the tax on sales. Therefore, the following penalties may apply to the **same** determination:

- RTC section 6511 penalty (10 percent for failure to file a return) may be applied with RTC section 6072 or 6094.5 penalty (improper use of resale certificate) since RTC section 6511 penalty is not for fraud or intent to evade the tax.
- Similarly, RTC section 7155 penalty (50 percent for failure to obtain a permit) may be added to the same determination if appropriate.

MULTIPLE PENALTIES-SPECIAL TAXES AND FEES 0511.05

The following examples illustrate various scenarios where multiple penalties may apply.

Example 1

Failure to Pay Due to Intent to Evade/Fraud-Cannabis Tax

Taxpayer timely filed cannabis tax returns for two quarters. The first quarter, the taxpayer timely paid 50% ($500,000) of the total $1,000,000 taxes shown as due per the return. The second quarter, the taxpayer paid 25% ($125,000) of the total $500,000 taxes shown as due but the payment was made after the due date. A 50% failure to pay penalty under RTC section 34013 of the Cannabis Tax Law and a 10% penalty for failure to pay timely under RTC section 55042 of the Fee Collection Procedures Law are assessed for the late return payments and as such, the system will automatically bill the taxpayer as outlined below:

Quarter	Tax Due per Return	Timely Payment	Paid Late	Balance after Return Due Date & Payments	Total Penalty Billed
1	$1,000,000	$500,000	N/A	$500,000	$300,000
2	$ 500,000	$0	$125,000	$375,000	$300,000
Total					$600,000

(Quarter 1: $500,000 x .50 = $250,000 and $500,000 x .10 = $50,000. $250,000 + $50,000 = $300,000.)

(Quarter 2: $500,000 x .50 = $250,000 and $500,000 x .10 = $50,000. $250,000 + $50,000 = $300,000.)

The mandatory 50 percent failure to pay penalty is required to be assessed on all department assessed billings, which includes audits, field billing orders (FBOs), estimated billings, and compliance billings.

Later during an audit, the auditor discovered a firm indication of criminal tax evasion. After consultation with their supervisor, the auditor sends a referral to the Tax Investigations & Inspections Bureau. The audit liability reflects an additional $1,875,000 in tax due and the following penalties:

RTC Penalty Description	Percent	Tax Liability	Total Penalty Assessed in Audit
34013(f) Failure to Pay	50%	$1,875,000	$937,500
55061(c) Fraud	25%	$1,875,000	$468,750
Total			$1,406,250

Due to the firm indication of fraud and the amount of the tax liability, the case is forwarded with a memo or email and Form CDTFA-876, *Tax Evasion Referral,* to Tax Investigations & Inspections Bureau for further review, which may result in the case being referred to a prosecutor for potential criminal prosecution. The referral should occur when a firm indication of criminal tax evasion is discovered. Fines could apply in addition to the penalties assessed if determined by the courts.

MULTIPLE PENALTIES-SPECIAL TAXES AND FEES **(CONT.1) 0511.05**

The following RTC sections should be reviewed when applying multiple penalties to Example 1:

Cannabis Tax Law RTC section:

- 34013 (f): **Failure to pay** 50% *(Relievable)*
- 34016 (d): **False or fraudulent report** Not to exceed $1,000 (*Misdemeanor Criminal fine*)

Fee Collection Procedures Law RTC section:

- 55061 (c): **Failure to pay or file due to fraud or intent to evade** 25%
- 55362: **Knowingly files a false return or report** Not less than $100 or more than $1,000 *(Misdemeanor-Criminal fine)*
- 55363: **Penalty for willful evasion or attempt to evade payment of fee** Not less than $5,000 and imprisonment *(Felony- Criminal fine)*

Example 2

Unlicensed and Failure to File-*Motor Vehicle Fuel*

During a monthly reporting period, a taxpayer's total tax due is $500,000 as determined by an audit examination. The taxpayer did not obtain the required *Motor Vehicle Fuel Supplier License* before becoming a supplier and did not file the CDTFA-501-PS, *Supplier of Motor Vehicle Fuel Tax*, Return. Neither evasion nor negligence were found by the auditor. Violation of RTC section 7726(b) is a misdemeanor subject to criminal fines if convicted (RTC section 8402). The tax, applicable penalties, and interest are immediately due and payable.

The following RTC sections apply to Example 2:

RTC	Penalty Description	Percent	Tax Liability	Total Penalty
7726(b)	Unlicensed Person	25%	$500,000	$125,000
7660	Failure to File	10%	$500,000	$50,000
Total				$175,000

RTC section:

- 7726(b): Unlicensed Person 25% of the amount of tax (relievable under RTC section 7726(b))
- 7660: Failure to File 10% (relievable under RTC Section 7657)
- 7675: Statute of Limitations 8 years

Example 3

Unlicensed, Failure to File, and Fraud-Diesel Fuel and Cigarette/Tobacco

A taxpayer's total tax due is $8,900 as determined by an audit examination. The taxpayer did not obtain the required license and fraud was determined by the auditor. The penalty for unlicensed person would apply at either 25% or $500, whichever is greater. For this example, the 25% penalty amount is greater. The 25% penalty for fraud, and the 10% failure to file penalty would also apply. The tax and penalty are immediately due and payable.

Although the fraud penalty is indicated in this example, since the tax liability is less than $25,000, the case would not be forwarded to the Tax Investigations & Inspections Bureau.

Diesel Fuel

The following RTC sections apply to Example 3 for a Diesel Fuel tax liability:

RTC	Penalty Description	Percent	Tax Liability	Total Penalty
60361	Unlicensed Person	25%	$8,900	$2,225
60303	Fraud	25%	$8,900	$2,225
60301	Failure to File	10%	$8,900	$890
Total				$5,340

RTC section:

- 60361: Unlicensed Person 25% of the amount of tax or five hundred dollars ($500), whichever is greater (Relievable under RTC section 60361)
- 60303: Fraud in case of No Return 25% plus 10% failure to file per 60301
- 60301: Failure to File 10% (Relievable-RTC section 60209)
- 60315: Statute of Limitations-None, due to fraud

Cigarette/Tobacco

The following RTC sections apply to Example 3 for a Cigarette or Tobacco Products tax liability:

RTC	Penalty Description	Percent	Tax Liability	Total Penalty
30211	Unlicensed Person	25%	$8,900	$2,225
30224	Fraud	25%	$8,900	$2,225
30221	Failure to File	10%	$8,900	$890
Total				$5,340

RTC section:

- 30211: Unlicensed Person 25% of the amount of tax or five hundred dollars ($500), whichever is greater (relievable under RTC section 30211)
- 30224: Fraud in case of No Return 25% plus 10% failure to file at RTC section 30221
- 30221: Failure to File 10% (relievable under RTC section 30282)
- 30207: Statute of Limitations-None, due to fraud

Example 4

No Permit and Failure to File-*Use Fuel Tax*

During a monthly reporting period, a taxpayer's total tax due is $5,000 as determined by an audit examination. The taxpayer did not obtain the required vendor use fuel tax permit before becoming a vendor and did not file the CDTFA-501-AV, *Vendor Use Fuel Tax Return*. Evasion was detected by the auditor. Violation of RTC section 9351 is a misdemeanor subject to criminal fines and/or imprisonment if convicted, plus the failure to file penalty as shown below.

RTC	Penalty Description	Percent	Tax Liability	Total Penalty
8801	Failure to File	10%	$5,000	$500
8804	Failure to File due to Fraud	25%	$5,000	$1,250
			Total	$1,750

Although the fraud penalty is indicated, since the liability is less than $25,000, the case would not be forwarded to the Tax Investigations & Inspections Bureau.

The following RTC sections should be reviewed when applying multiple penalties to Example 4:

RTC section:

- 9351: **Violations: misdemeanor for no permit** *fine* of not less than $100 and not more than $1,000 for each offense and/or imprisonment
- 8801: **Failure to File** 10% (*relievable under* RTC section 8877)
- 8804: **Failure to File due to Fraud** 25% (*relievable* under RTC section 8877)
- 8782: **Statute of Limitations-None**, due to fraud

Example 5

Backup Tax Penalty, Misuse of Exemption Certificate, and Fraud

(Scenario could apply to both MVF and diesel fuel, but the example shown below reflects diesel fuel only)

Over a three-and-a-half-year period, taxpayer purchased 170,051 gallons ex-tax diesel fuel under an exemption certificate and used it in a taxable manner resulting in a liability for the backup tax. The auditor determined that there was an intent to evade the taxes, so the three year statute of limitations does not apply, resulting in 170,051 gallons subject to the backup tax at the applicable tax rates and a tax liability of $51,421. The backup tax penalty is calculated at the greater of 25% of the tax or $500. This amount is then compared to the greatest of the potential misuse of exemption certificate penalty at either 25% of the tax or $1,000 per certificate issued.

For this scenario, it was assumed the 25% of the tax misuse of exemption certificate penalty exceeds the $1,000 penalty per exemption certificate issued. The backup tax penalty is also 25% of the tax. Therefore, the misuse of exemption certificate penalty would be assessed since evasion was determined. However, the backup tax penalty is not imposed because it does not exceed any other applicable penalty. The backup tax, interest and penalties for misuse of an exemption certificate and fraud will be immediately due and payable:

RTC	Penalty Description	Percent	Tax Liability	Total Penalty
60503.2 or 60106.3	Misuse of exemption certificate (farming/bus operator or train operator)	25%	$51,421	$12,855
60313	Fraud	25%	$51,421	$12,855
Total				$25,710

Due to the evasion penalty indicated, if the diesel fuel tax liability aggregates $25,000 or more in any 12-consecutive month period, and if the program area believes that felony prosecution may be warranted, the case may be forwarded with a fraud cover memo or email and Form CDTFA-876, *Tax Evasion Referral*, to the Tax Investigations & Inspections Bureau for further review. The case may then result in it being referred to a prosecutor for potential criminal prosecution. The referral should occur when a firm indication of criminal tax evasion is discovered.

NOTE: RTC section 60708 provides the statute of limitation for filing criminal charges with the court: Any prosecution for violation of any of the penal provisions of this part shall be instituted within three years after the commission of the offense, or within two years after the violation is discovered, whichever is later.

The following RTC sections should be reviewed when applying multiple penalties to Example 5:

- 60361.5: **Backup Tax Penalty** 25% or $500 whichever is greater. The result must be compared to the penalties of RTC sections 60503.2 and 60106.3. Only the penalty totaling the greatest amount shall be imposed, and the penalty at RTC section 60361.5 may be imposed only if it exceeds any other applicable penalty. (Relievable at 60361.5 (d))
- 60503.2 or 60106.3: **Misuse of Exemption Certificate** (farming/bus operator or train operator) 25% or $1,000, whichever is greater, for each certificate issued. This requires an intention to evade the taxes. Imposition of either of these penalties means the taxpayer is guilty of either a misdemeanor or a felony. (Not Relievable)
- 60313: **Fraud** 25% of deficiency determination (there is no reporting requirement, so RTC section 60303 is not applicable.)
- 60706 **Misdemeanor fine** not less than $1,000 nor more than $5,000, imprisonment, or both fine and imprisonment in the discretion of the court.
- 60707: **Felony fine** if the tax liability aggregates $25,000 or more in any 12-consecutive-month period, fine will be not less than $5,000 and not more than $20,000, or imprisonment or both fine and imprisonment in the discretion of the court.
- 60707.1 **Additional felony fine** of up to $2 for each gallon in violation
- 60315: **Statute of Limitations** – None, evasion determined. Either misuse of exemption certificate or fraud penalty to be imposed.

Example 6

Backup Tax and Dyed Diesel Fuel Penalties-Diesel *Fuel Tax*

RTC section 60058 of the Diesel Fuel Tax Law includes provisions for when the backup tax will be charged. When the backup tax does apply, it will be imposed, and is immediately due with any applicable interest and penalties. The backup tax penalty will not be imposed on a dyed diesel fuel violation because the law provides that only the larger of the dyed diesel fuel penalty or the backup tax penalty will be imposed. Since the dyed diesel fuel penalties are always larger than the backup tax penalty, they will always be imposed and the backup penalty will not be due.

The dyed diesel fuel penalty is assessed for each violation, at either $10 per gallon or a flat rate of $1,000 per penalty, multiplied by the number of penalties.

For example, a taxpayer has three vehicles fueled with dyed diesel fuel. On July 27, 2021, the taxpayer is traveling in a convoy down a state highway and its three vehicles are stopped at an inspection site. The stopping of each vehicle is a separate event. Penalties would be due for each event. The penalty would be the greater of $10 per gallon of dyed diesel fuel contained in each vehicle's fuel tanks or the flat rate penalty. The backup tax would be due because it is presumed that the vehicle operator delivered the dyed diesel fuel into the vehicle tanks. The following chart demonstrates this calculation:

Vehicle	Gallons in Vehicle Tank	Penalty at $10 per gallon	Flat Rate Penalty	Backup Tax at $0.389 per Gallon	Tax and Penalty to be Billed
Vehicle# 1	150	$1,500	$1,000	$19.45	$1,519.45
Vehicle# 2	100	$1,000	$2,000	$38.90	$2,038.90
Vehicle# 3	50	$500	$3,000	$58.35	$3,058.35
Total				$116.70	$6,616.70

As a follow-up to the on-the-highway stops, an investigation is conducted of taxpayer's business. The auditor discovers two more highway vehicles, each containing dyed diesel fuel. The investigation also disclosed that the taxpayer was storing dyed diesel fuel in two on-site storage tanks:

- Tank "A" contained 50 gallons of dyed diesel fuel. The taxpayer admitted that he was experimenting with removing the dye from the 50 gallons of dyed diesel fuel in tank "A."
- Tank "B" contained 1,000 gallons of dyed diesel fuel, and did not have the required signage stating it was dyed diesel fuel.

These violations are added to the prior three violations, so the flat rate penalty increases accordingly, resulting in the following billed amounts:

Vehicle	Gallons in Vehicle Tank	Penalty at $10 per gallon	Flat Rate Penalty	Backup Tax at $0.389 per Gallon	Tax and Penalty to be Billed
Vehicle# 4	75	$750	$4,000	$29.18	$ 4,029.18
Vehicle# 5	200	$2,000	$5,000	$ 77.80	$ 5,077.80
Tank "A"*	50	$500	$6,000	NIA	$ 6,000.00
Tank "B"*	1,000	$10,000	$7,000	NIA	$10,000.00
Total				$106.98	$25,106.98

*The backup tax is not due until fuel has been placed into a vehicle tank.

The following RTC sections should be reviewed when applying multiple penalties to Example 6:

RTC section:

- 60361.5 **Backup Tax Penalty:** 25% of the amount of tax or $500, whichever is greater. Must be compared to penalties at RTC section 60105, 60106.3, and 60503.2. Only the penalty totaling the greatest amount shall be imposed, and the penalty at RTC section 60361.5 may be imposed only if it exceeds *any other applicable penalty. [relievable under* RTC section 60361.5(d)]
- 60105 **Dyed Diesel Fuel Penalties**: Multiple penalties for dyed diesel fuel violations may be assessed depending on the violations, as shown below:
  - 60105 (a)(l) **Dyed Diesel Fuel Penalty *(selling):*** A person sells or holds for sale dyed diesel fuel for a use that they know or have reason to know, is taxable use. Penalty $10 per gallon or $1,000 times the total number of penalties, including current occurrence. *(not relievable)*
  - 60105 (a)(2) **Dyed Diesel Fuel Penalty *(using):*** A person holds for use or used dyed diesel fuel for taxable use. $10 per gallon or $1,000 times the total number of penalties, including current occurrence. *(not relievable)*
  - 60105 (a)(3) **Dyed Diesel Fuel Penalty *(altering):*** A person knowingly alters, or attempts to alter, the strength or composition of any dye or marker in any dyed diesel fuel. *(not relievable)*
  - 60105 (a)(4) **Dyed Diesel Fuel Penalty *(failing to provide notice):*** A person fails to provide or post the required dyed diesel fuel notice per RTC section 60102. $10 per gallon or the product of $1,000 and the total number of penalties, including current occurrence. *(not relievable)*

60315 Statute of Limitations – Three years.

APPLYING SECTION 6597 IN CONJUNCTION WITH AN EVASION PENALTY 0511.10

If the auditor finds clear and convincing evidence the taxpayer intended to evade the payment of tax collected, then determinations may be extended beyond the three or eight-year statute of limitations set forth in RTC section 6487 or ten-year statute of limitations set forth in RTC section 7073 (d). The 40-percent penalty should be applied to unremitted tax collected, including in the extended periods for which there are records to establish and support a tax liability. A memorandum must be prepared in accordance with Audit Manual section 0511.15 and include all relevant elements for recommending a finding of evasion (0509.40) and the 40-percent penalty (section 0510.00).

When there are errors in addition to unremitted tax collected and the evidence of an intent to evade is not solely related to the unremitted tax collected, fraud should be asserted under the applicable statute(s). Only the 40-percent penalty should be applied to unremitted tax collected errors, including in the extended periods for which there are records to establish tax liability by a preponderance of evidence, and the evasion penalty will generally be applied to the remaining errors in the audit, unless it would be inequitable (see Audit Manual section 0509.35). The system allows the 40-percent penalty and an evasion penalty to be added to different audit error items within the same audit period, provided it is done at the "period level" rather than at the "audit level." Therefore, a split billing is not necessary. If there are other errors, in addition to unremitted tax collected, but the evidence of evasion is solely related to the unremitted tax collected, it may not be equitable to apply an evasion penalty to the other errors in the audit. In these instances, auditors can utilize the "period level" penalties in the system to assert the 40-percent penalty on the periods that include unremitted tax collected only. The only two penalties the system will not allow in the same audit period are the fraud penalty and the negligence penalty. All other penalties can be combined utilizing the "period level" sections in the system, as appropriate.

MEMORANDUM FOR EVASION PENALTY IN CONJUNCTION WITH 6597 PENALTY 0511.15

When fraud is asserted in an audit that also includes the 40-percent penalty, only one memorandum from the Administrator to the Deputy Director, FOD is required. A memorandum that recommends a finding of evasion **and** imposition of the section 6597 penalty in the same determination, should contain separate sections for each penalty recommendation. The evasion penalty for fraud section must include all of the relevant elements and supporting documentation for a fraud memorandum as instructed in Audit Manual section 0509.40, and the section 6597 penalty section must include all relevant elements (including how the thresholds are met) as discussed in section 0510.05.

When a taxpayer provides an explanation for failure to remit the tax, it is the Administrator's responsibility to evaluate the explanation. The Administrator will evaluate the taxpayer's explanation to determine whether the person's failure to timely remit the tax was due to reasonable cause and/or circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care, and absence of willful neglect. RTC section 6597 provides specific examples of what constitutes "reasonable cause or circumstances beyond the person's control." If the penalty is not applied to any, or only some of the periods, auditors must document the taxpayer's explanation in CRM Notes in the system for an audit or FBO. If the penalty is applied, the Verification Comments, "Penalty", must include the comment, "Penalty of 40% has been added for unremitted tax collected."

When an audit recommends the 6597 penalty, a memorandum is required from the Administrator to the Deputy Director, FOD. See AM section 0510.00, *Failure to Remit Sales Tax Reimbursement or Use Tax (RTC 6597),* for more information on this memorandum.

APPLYING 6597 AND NEGLIGENCE 0511.20

When the section 6597 penalty is warranted for only a portion of a determination and there is insufficient evidence to establish that any part of the determination is due to fraud, the appropriate penalty for the remainder of the deficiency determination may be the section 6484 10-percent negligence penalty. This combination of penalties must be done at a period level in the system.

SPLIT BILLINGS WHEN APPLYING 6597 PENALTIES AND NON-EVASION PENALTIES 0511.25

The section 6597 penalty applies only when it is established by a preponderance of evidence that a taxpayer knowingly collected the sales tax reimbursement or use tax and failed to remit it. The system allows the 40-percent penalty and an additional penalty (for example, a negligence penalty) to be added to different audit items **within the same quarter**. However, the system will allow the 6597 penalty and another non-evasion penalty within the same audit period, but it must be done at the "period level" and not at the "audit level."

MISCELLANEOUS 0512.00

FAILURE TO OBTAIN EVIDENCE THAT AN OPERATOR OF A CATERING TRUCK HOLDS A VALID SELLER'S PERMIT 0512.05

Pursuant to RTC section 6074, CDTFA may require any person making sales to an operator of a catering truck to obtain evidence that the operator is the holder of a valid seller's permit, issued pursuant to RTC section 6067. Persons who fail to comply with that requirement to obtain evidence shall be liable for a penalty, not to exceed five hundred dollars ($500), for each such failure to comply.

FAILURE OF A RETAIL FLORIST TO OBTAIN A PERMIT 0512.10

Pursuant to RTC section 6077, any retail florist (including a mobile retail florist) who fails to obtain a seller's permit before engaging in or conducting business as a seller shall, in addition to any other applicable penalty, pay a penalty of five hundred dollars ($500). For purposes of RTC section 6077, "mobile retail florist" means any retail florist who does not sell from a structure or retail shop, including, but not limited to, a florist who sells from a vehicle, pushcart, wagon, or other portable method, or who sells at a swap meet, flea market, or similar transient location. The term "retail florist" does not include any flower or ornamental plant grower who sells his or her own products.

PENALTIES IN BANKRUPTCY CASES 0512.20

In bankruptcy cases, tax penalties for pre-bankruptcy periods should be determined in the same manner as for persons not in bankruptcy. Penalties are not entitled to the same priority treatment as pre-bankruptcy taxes and accrued interest. However, penalties may be entitled to a distribution under a lesser priority. The Collection Support Bureau will make an evaluation whether to include penalties in a proof of claim to be filed in a bankruptcy case. When a tax penalty is not discharged in a bankruptcy case, the penalties associated with the tax liability are likewise not discharged and any penalty should be included in the determination so it can be collected from the tax debtor.

The date the bankruptcy petition is filed must be noted in the audit. Pre-petition and post-petition penalties should be separately identified in each (pre and post) audit.

RECEIVERS, TRUSTEES AND DEBTORS IN POSSESSION 0512.25

A court-appointed receiver, bankruptcy trustee, or taxpayer/bankruptcy debtor (acting as a debtor-in-possession) may operate the business of a taxpayer following the commencement of litigation against a taxpayer or the commencement of a bankruptcy case. Accordingly, penalties that attach due to the delinquency or malfeasance of a receiver, trustee, or debtor-in-possession while operating the business will be billed to the receiver, trustee, or debtor-in-possession and, when appropriate, asserted as a claim against the receivership or bankruptcy estate.

NEGLIGENCE AND EVASION PENALTIES — DECEASED TAXPAYERS 0512.30

Negligence and evasion penalties will not be included in determinations made after the death of an individual taxpayer. It is obvious that the malfeasant in such cases would not suffer the penalty, and the effect would be to reduce the assets for distribution to the estate of the deceased. However, such penalties are applicable to the negligence of the administrator(s) or executor(s) of the decedent's estate, or their intent to evade the payment of tax or fee.

NEGLIGENCE AND EVASION PENALTIES —DEATH OF PARTNER 0512.35

If a partnership is properly subject to a negligence or evasion penalty, that penalty will still be imposed even if the partnership is thereafter dissolved due to the death of one of the partners.

ASSIGNMENT FOR THE BENEFIT OF CREDITORS 0512.40

Any person who makes an assignment for the benefit of creditors and who owes an amount which became delinquent either before or after the assignment was made, is charged with penalty and interest, when applicable, the same as other taxpayers.

Table of Exihibits

Sample Warning Letter — Misuse of a Resale Certificate Exhibit 1

Date

ABC Company
One Main Street
Sacramento, CA 95814

In Reply Refer To:
Account number

Dear Mr. Jones:

The California Department of Tax and Fee Administration has reviewed the records of one of your vendors and found resale certificates were issued by your company for items that do not appear to be of a type normally resold by your business. While the resale certificate may have been properly issued, in some cases businesses are not aware of the proper use of resale certificates.

The purpose of this letter is to remind you that resale certificates may only be issued for merchandise you intend to resell. Your seller's permit does not allow you to purchase property without tax for personal or business use. In fact, a purchaser who knowingly issues a resale certificate for the purpose of evading payment of the sales and use tax may be subject to one or more of the following penalties:

- A penalty of $500 or 10% of the amount of tax due, whichever is greater, for each misuse of a resale certificate.
- A 25% penalty for intent to evade the tax.
- Revocation of the seller's permit.

At this time, we are not asking for any further information or action on any specific transactions.

If you have any further questions or concerns, please do not hesitate to contact us at the above address or call our Customer Service Center at (800) 400-7115. You may also visit our website at www.cdtfa.ca.gov.

Sincerely,

Sample Letter Imposing Penalty for Misuse of a Resale Certificate Exhibit 2

Date

ABC Company
One Main Street
Sacramento, CA 95814

In Reply Refer To:
Account number

Dear Mr. Jones:

We have reviewed your response to our letter and the statement concerning "Property Purchased Without Payment of California Sales Tax." Based on the information you provided, it has been determined that a $500 penalty for Misuse of a Resale Certificate is applicable. This penalty is in addition to the tax and interest on the same transaction.

The penalty for Misuse of a Resale Certificate is authorized pursuant to section 6094.5 of the Revenue and Taxation Code which states as follows:

> *Any person, including any officer or employee of a corporation, who gives a resale certificate for property, which he or she knows at the time of purchase is not to be resold by him or her or the corporation in the regular course of business, is liable to the state for the amount of tax that would be due if he or she had not given such resale certificate. In addition to the tax, the person shall be liable to the state for a penalty of 10% of the tax or five hundred dollars ($500), whichever is greater, for each purchase made for personal gain or to evade the payment of taxes.*

Please respond within the 10 days of the date of this letter if you do not agree with the imposition of any portion of this decision. I will consider any additional information that you provide before preparing my recommendation.

While there is no interest imposed upon penalties and interest, interest does continue to accrue on the amount of unpaid tax. For your convenience, I have enclosed Form CDTFA-1, *Audit Payment Information*. If you wish to make a payment toward any amount of tax, please return the bottom portion of the form with your payment and include the phrase "Misuse of Resale Certificate Billing" with your remittance so that we may properly credit your account.

If you have any further questions, please feel free to contact me at the telephone number or address shown above.

Sincerely,

Enclosure: CDTFA-1, *Audit Payment Information*