



## Proposed Regulation Agency Background Document

<b>Agency name</b>	Department of Taxation
<b>Virginia Administrative Code (VAC) citation</b>	23 VAC 10-210-2032
<b>Regulation title</b>	Chapter 210 – Retail Sales and Use Tax
<b>Action title</b>	Amend penalty and interest regulation as it pertains to audits to reflect an administrative change in TAX's policy
<b>Date this document prepared</b>	August 7, 2007

This information is required for executive branch review and the Virginia Registrar of Regulations, pursuant to the Virginia Administrative Process Act (APA), Executive Orders 36 (2006) and 58 (1999), and the *Virginia Register Form, Style, and Procedure Manual*.

### Brief summary

*In a short paragraph, please summarize all substantive changes that are being proposed in this regulatory action.*

This regulation has been amended to reflect an administrative change allowing sales and use tax audit candidates an alternative method to calculate their use tax compliance to include sales taxes paid to vendors on taxable purchases. The regulation has also been amended to expand the definitions section to define terms used in calculating the alternative use tax compliance. This change was instituted at the request of businesses and various industry groups.

### Legal basis

*Please identify the state and/or federal legal authority to promulgate this proposed regulation, including (1) the most relevant law and/or regulation, including Code of Virginia citation and General Assembly chapter number(s), if applicable, and (2) promulgating entity, i.e., the agency, board, or person. Describe the legal authority and the extent to which the authority is mandatory or discretionary.*

Code of Virginia § 58.1-203 provides that the “Tax Commissioner shall have the power to issue regulations relating to the interpretation and enforcement of the laws of this Commonwealth governing taxes administered by the Department.” The authority for the current regulatory action is discretionary.

## Purpose

*Please explain the need for the new or amended regulation by (1) detailing the specific reasons why this regulatory action is essential to protect the health, safety, or welfare of citizens, and (2) discussing the goals of the proposal, the environmental benefits, and the problems the proposal is intended to solve.*

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Businesses and various industry groups have always advocated that TAX’s method of calculating use tax compliance in audit situations unfairly omits sales taxes paid to vendors, a component they believe more accurately reflects their compliance efforts to comply with the sales and use tax statutes. This regulation has been amended to allow an alternative method for computing use tax compliance that does include sales taxes paid to vendors on taxable purchases. It is anticipated that this amendment will reduce the assessments of audit penalty as it relates to use tax compliance and reduce the number of appeals and offers in compromise submitted to TAX.

## Substance

*Please briefly identify and explain the new substantive provisions, the substantive changes to existing sections, or both where appropriate. (More detail about these changes is requested in the “Detail of changes” section.)*

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This regulation has been amended to reflect an administrative change allowing sales and use tax audit candidates an alternative method to calculate their use tax compliance to include sales taxes paid to vendors. The regulation has also been amended to expand the definitions section to define terms used in calculating the alternative use tax compliance. This change was instituted at the request of businesses and various industry groups.

During sales and use tax audits, TAX calculates the use tax compliance of a business. The use tax compliance measures the businesses compliance in accruing and remitting the Virginia use tax on untaxed purchases. The level of the use tax compliance ratio, calculated as a percentage, determines the application of audit penalty to use tax liabilities resulting from audit. TAX’s use tax compliance calculation does not include taxes paid to vendors. This regulation has been amended to allow an alternative method for calculating use tax compliance that does include sales taxes paid to vendors.

## Issues

*Please identify the issues associated with the proposed regulatory action, including:*

- 1) the primary advantages and disadvantages to the public, such as individual private citizens or businesses, of implementing the new or amended provisions;*
- 2) the primary advantages and disadvantages to the agency or the Commonwealth; and*
- 3) other pertinent matters of interest to the regulated community, government officials, and the public.*

*If the regulatory action poses no disadvantages to the public or the Commonwealth, please so indicate.*

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The assessment of penalty in audit situations is determined based on an established level of compliance as computed by the sales and use tax compliance ratio. For use tax compliance (the level in which a business self-assesses use tax on untaxed purchases), TAX's audit program does not include sales taxes paid to vendors in its calculation. The alternative method of computing use tax compliance proposed in this regulation allows businesses the option of calculating their use tax compliance to include sales taxes paid to vendors. The alternative method will increase businesses likelihood that they will meet the tolerances established by TAX and avoid the assessment of use tax penalty in audit situations. This alternative method is also advantageous to TAX as it will reduce the number of audit appeals and offers in compromises as they relate to audit penalty.

The regulatory action poses no disadvantages to the public or the Commonwealth.

### Requirements more restrictive than federal

*Please identify and describe any requirement of the proposal which are more restrictive than applicable federal requirements. Include a rationale for the need for the more restrictive requirements. If there are no applicable federal requirements or no requirements that exceed applicable federal requirements, include a statement to that effect.*

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There are no federal requirements applicable to this regulatory action.

### Localities particularly affected

*Please identify any locality particularly affected by the proposed regulation. Locality particularly affected means any locality which bears any identified disproportionate material impact which would not be experienced by other localities.*

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No localities are particularly affected by this regulatory action.

### Public participation

*Please include a statement that in addition to any other comments on the proposal, the agency is seeking comments on the costs and benefits of the proposal and the impacts of the regulated community.*

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In addition to any other comments, the board/agency is seeking comments on the costs and benefits of the proposal and the potential impacts of this regulatory proposal. Also, the agency/board is seeking information on impacts on small businesses as defined in § 2.2-4007.1 of the Code of Virginia. Information may include 1) projected reporting, recordkeeping and other administrative costs, 2) probable effect of the regulation on affected small businesses, and 3) description of less intrusive or costly alternative methods of achieving the purpose of the regulation.

Anyone wishing to submit written comments may do so by mail, email or fax to Bland Sutton, PO Box 27185, Richmond, Virginia 23261-7185, Telephone: (804) 371-2332, FAX: (804) 371-2355, E-mail: [Bland.Sutton@tax.virginia.gov](mailto:Bland.Sutton@tax.virginia.gov). Written comments must include the name and address of the commenter. In order to be considered comments must be received by the last date of the public comment period. Interested parties are encouraged to submit their comments on the Town Hall.

A public hearing will be held and notice of the public hearing may appear on the Virginia Regulatory Town Hall website ([www.townhall.virginia.gov](http://www.townhall.virginia.gov)) and can be found in the Calendar of Events section of the Virginia Register of Regulations. Both oral and written comments may be submitted at that time.

**Economic impact**

*Please identify the anticipated economic impact of the proposed regulation.*

<p><b>Projected cost to the state to implement and enforce the proposed regulation, including (a) fund source / fund detail, and (b) a delineation of one-time versus on-going expenditures</b></p>	<p>As the proposed regulatory activity is an administrative change that provides an alternative method for computing the use tax compliance ratio in audit situations, there are no anticipated costs to the state.</p>
<p><b>Projected cost of the regulation on localities</b></p>	<p>As the proposed regulatory activity is an administrative change that provides an alternative method for computing the use tax compliance ratio in audit situations, there are no anticipated costs to the localities.</p>
<p><b>Description of the individuals, businesses or other entities likely to be affected by the regulation</b></p>	<p>This regulation will affect all businesses that may be the subject of Virginia sales and use tax audits.</p>
<p><b>Agency’s best estimate of the number of such entities that will be affected. Please include an estimate of the number of small businesses affected.</b> Small business means a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than \$6 million.</p>	<p>TAX audits approximately 3,000 businesses annually for sales and use tax. It is unknown how many of these would qualify as small businesses.</p>
<p><b>All projected costs of the regulation for affected individuals, businesses, or other entities. Please be specific. Be sure to include the projected reporting, recordkeeping, and other administrative costs required for compliance by small businesses.</b></p>	<p>The alternative method for computing use tax compliance is at the discretion of the business under audit. If the business elects not to utilize the alternative method, the business incurs no costs. If the business elects to use the alternative method, it is the responsibility of the business to calculate the alternative compliance ratio and the business will incur the associated costs. The administrative cost for businesses electing to utilize the alternative use tax compliance ratio is unknown.</p>

**Alternatives**

*Please describe any viable alternatives to the proposal considered and the rationale used by the agency to select the least burdensome or intrusive alternative that meets the essential purpose of the action. Also, include discussion of less intrusive or less costly alternatives for small businesses, as defined in §2.2-4007.1 of the Code of Virginia, of achieving the purpose of the regulation.*

The Department considered alternatives to the proposed regulatory action. Doing nothing would leave the regulation inconsistent with the statute. Repealing the regulation would reduce the level of customer service and, as a result, tend to reduce the level of voluntary compliance with the tax laws. Audit and compliance activity would produce less uniform results and would be much less effective in enforcing the tax laws.

Since 1980, administrative interpretations of the tax laws that are not in the form of published rulings or a regulation have not been admissible as evidence in court. Code of Virginia § 58.1-205. Even published “rulings and policies themselves are not entitled to great weight, unless expressed in regulations.” Chesapeake Hospital Authority v. Commonwealth, 262 Va. 551, 554 S.E.2d 55 (2001). Therefore, to ensure enforcement, it is necessary to promulgate regulations containing the Tax Commissioner’s interpretations of the tax laws.

**Regulatory flexibility analysis**

*Please describe the agency’s analysis of alternative regulatory methods, consistent with health, safety, environmental, and economic welfare, that will accomplish the objectives of applicable law while minimizing the adverse impact on small business. Alternative regulatory methods include, at a minimum: 1) the establishment of less stringent compliance or reporting requirements; 2) the establishment of less stringent schedules or deadlines for compliance or reporting requirements; 3) the consolidation or simplification of compliance or reporting requirements; 4) the establishment of performance standards for small businesses to replace design or operational standards required in the proposed regulation; and 5) the exemption of small businesses from all or any part of the requirements contained in the proposed regulation.*

The Department has considered modifying the regulatory methods for small businesses. The regulatory methods follow the least intrusive and burdensome method consistent with statutory language, and could not be made less burdensome for small businesses without jeopardizing the enforcement of the tax laws.

**Public comment**

*Please summarize all comments received during public comment period following the publication of the NOIRA, and provide the agency response.*

Commenter	Comment	Agency response

**Family impact**

*Please assess the impact of the proposed regulatory action on the institution of the family and family stability including to what extent the regulatory action will: 1) strengthen or erode the authority and rights of parents in the education, nurturing, and supervision of their children; 2) encourage or discourage economic self-sufficiency, self-pride, and the assumption of responsibility for oneself, one’s spouse, and one’s children and/or elderly parents; 3) strengthen or erode the marital commitment; and 4) increase or decrease disposable family income.*

This regulatory action is not expected to have an impact on family formation, stability and autonomy.

**Detail of changes**

*Please detail all changes that are being proposed and the consequences of the proposed changes. Detail all new provisions and/or all changes to existing sections.*

*If the proposed regulation is intended to replace an emergency regulation, please list separately (1) all changes between the pre-emergency regulation and the proposed regulation, and (2) only changes made since the publication of the emergency regulation.*

For changes to existing regulations, use this chart:

<b>Current section number</b>	<b>Proposed new section number, if applicable</b>	<b>Current requirement</b>	<b>Proposed change and rationale</b>
10-210-2032	N/A	Current regulation does not reflect an administrative change in TAX's policy for calculating an alternative method for computing the use tax compliance ratio for audits.	Effective October 1, 1999, TAX allowed the use of an alternative method of computing the use tax compliance ratio in audit situations. This alternative method is an administrative change for TAX and is not reflected in the statute. This regulation has been amended to reflect the alternative method for computing use tax compliance.
10-210-2032	N/A	The alternative method for computing the use tax compliance ratio contains terminology not previously used in the regulation.	The proposed regulation expands on the definition section to define terms relevant to the computation of the alternative method for computing use tax compliance.
10-210-2032	N/A	The current compliance ratio used to measure taxpayer's compliance in audit situations is calculated by the audit software utilized in the audit process.	The use of the alternative method for computing the use tax compliance ratio is at the discretion of the taxpayer and the calculation of the ratio is the responsibility of the taxpayer. This transfer of responsibility is unique to the use of the alternative use tax compliance ratio and it is imperative that this responsibility be conveyed in the form of a regulation.