



COLORADO DEPARTMENT OF REVENUE
GUIDE TO THE MANAGED AUDIT PROGRAM
FOR
SALES AND USE TAXES

AS OF June 21, 2006

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Preface

This publication provides general information regarding the Department of Revenue’s Managed Audit Program as well as specific instructions for managed audit procedures.

Note

The statements in this publication are general and are current as of June 2006. The sales and use tax law is complex and subject to change. If there is a conflict between this publication and the law, any decisions will be based on the law and not on this publication.

1. Introduction

This publication provides general information regarding our Managed Audit Program. The program allows certain businesses to conduct a type of self-audit with instructions and guidance from one of our auditors. If you qualify for a managed audit and we approve your participation, you will enter into a Managed Audit Program (MAP) Participation Agreement (see page 12) and conduct many of the audit tasks that would ordinarily be performed by our auditor. This publication provides general information on the program and specific instructions for audit procedures.

Why should I do part of the audit work myself?

If you complete a managed audit and owe additional tax, penalty and penalty interest will be waived. This can result in significant savings to you.

There are other benefits, too. In a conventional audit, our auditor typically reviews your records at your place of business, during working hours. In a managed audit, you can review your records whenever and wherever you like, as long as you finish your work within the time specified.

You may gain a more thorough understanding of how tax applies to your business transactions, what kind of records you should keep, and how to improve your business procedures that relate to sales and use tax. This may not only help you in your ongoing business operations but can help ensure that any future audits go more smoothly.

Your decision to participate in a managed audit does not affect your right to protest the audit results. In addition, your participation is entirely voluntary. There are no adverse consequences for choosing to have the Department of Revenue conduct your audit in the usual manner.

What kind of work will I be doing?

Under the direction of our auditor and using instructions provided in your MAP Participation Agreement and this booklet, you will review your records to determine whether you have fully met your obligations under state, state administered local, and state administered district sales and use tax laws. You may be asked to review a representative sample of your sales and purchases or every transaction in the audit period.

Typically, you will examine your sales records to see whether you:

- Correctly calculated and reported the sales tax due on your transactions.
- Have the required documentation to support any sales tax exemptions or exclusions you have claimed.

You will typically review your purchase records to determine:

- Whether you paid Colorado and DOR administered local sales or use tax on the purchase.
- Whether you correctly calculated and reported the tax.

As you conduct the reviews, you'll fill out transaction worksheets with the information needed to determine whether you paid the correct amount of tax during the audit period. Our auditor may also ask you to perform additional audit tasks, such as reviewing your sales tax returns. The auditor will review your work when you're done and determine whether you owe more tax, whether you are owed a refund, or whether your sales and use tax returns were correct as filed.

How will I know what to do?

Our auditor will indicate in the MAP Participation Agreement which books, records, and equipment purchases you must consider in your review and provide you with detailed instructions.

How much of my time will it take?

The amount of time needed to conduct the audit work will vary, depending on your business operations and records. Our auditor will give you an estimate of the time required, based on his or her experience.

What happens when I'm done with my portion of the work?

When you've reviewed all of your records and completed the necessary worksheets, our auditor will review and verify your work to determine whether you adequately followed instructions and addressed any problem areas. When satisfied that you have accurately completed your part of the work, the auditor will complete the audit and arrange a conference with you to explain the audit results.

For more information regarding notification of audit results and subsequent steps in the process, please contact the field audit section directly at *Colorado Department of Revenue, Field Audit Section, 400 S Colorado Blvd, Suite 400, Denver, CO 80246, 303-355-0400*.

Will the auditor review any of the transactions?

Certain types of transactions are not appropriate for review in a managed audit, for example, those involving complex legal issues. If your records include such transactions, our auditor will notify you and let you know which books and records to make available for review. If our auditor's review indicates that you owe additional tax on these transactions, penalty and penalty interest will not be assessed, provided you are still approved to participate in the Managed Audit Program.

Why is my business eligible for the Managed Audit Program?

Your business meets the criteria for our Managed Audit Program if the tax issues in your business are generally straightforward, your transactions are not subject to a

number of sales tax exemptions, you have a history of satisfactory compliance, and you have the resources necessary to do the work. Requests to perform consecutive managed audits will generally not be approved.

Our auditor will review your work before completing the audit.

Is there anything that guarantees that penalty and penalty interest will be waived?

Yes. If you choose to participate in a managed audit, you will enter into a MAP Participation Agreement with us (see sample on page 12). The agreement will:

Contain your name and account number.

Specify the period of time covered by the audit.

Specify a reasonable time period for you to complete your work.

Specify the types of transactions and records to be reviewed.

Specify the review method and the periods for the records that will be reviewed.

Specify circumstances under which we may void the agreement.

Specify the time period in which you must pay any tax and interest due.

Specify the penalty and penalty interest to be waived upon successful completion of the managed audit.

The agreement explains the terms and conditions of your managed audit. Please read it carefully before you sign and date it. The managed audit agreement must be signed by an officer of the corporation with authority to bind the corporation, a general partner of a partnership, or the owner of a sole proprietorship. The Field Audit Section Chief Auditor will also sign and date the agreement. You'll receive a copy for your records.

Can the Department of Revenue terminate the MAP Participation Agreement?

Under certain circumstances, at the discretion of the Executive Director of the Department of Revenue, we can terminate (void) a MAP Participation Agreement. The agreement form includes examples of events that may cause us to take this action. Please see number 10 of the managed audit agreement and note this list is not exhaustive.

Please note that events leading to termination of the agreement by the Executive Director are unlikely to occur in a managed audit where the taxpayer cooperates fully with the auditor. If the Department terminates the MAP Participation Agreement, you will not receive the benefit of the waived penalty and penalty interest.

How long do I have to decide whether a managed audit is right for me?

Ask our auditor. The auditor must begin the audit as soon as possible and will need to make audit plans based on your response. The auditor will usually give you a few days to consider how you would like to proceed.

What if I change my mind after I've started?

If after starting the work, you decide not to complete the managed audit, or you do not complete the work that you agreed to do, our auditor will finish the job. In addition to

statutory interest, penalty and penalty interest may then apply to any liability disclosed by the audit.

2. Reviewing your sales

During an audit, the auditor customarily checks your sales records to be sure that you:

- Computed the correct amount of tax.
- Properly reported tax on your transactions.
- Have documents in your records that support any untaxed sales.

In a managed audit, you will be doing this verification yourself. To help you determine whether you have properly reported tax, our auditor will provide you with publications that describe the most common nontaxable sales and charges: sales for resale, sales delivered outside Colorado, shipping and delivery charges, and sales to the U.S. Government. The auditor will also give you information regarding cash discounts and nontaxable charges such as installation or repair labor. 39-26-105 C.R.S. and regulation 39-26-102.5, and 39-26-111; regulation 39-26-102.12; special regulations for specific industries.

Following the above described verification work conducted by the taxpayer, the auditor will review the verification work to the extent the auditor determines is necessary.

Assembling your records for review

Our auditor will indicate in the MAP Participation Agreement which records you will review in the managed audit, as well as the test period and method you will use, which may include sampling.

Verifying information in your records

You will need to carefully review your invoices, following procedures explained by our auditor and detailed in this section.

If you added an amount for tax to the sale:

If your invoice shows that you added an amount for tax to the sale, you need to check the invoice to determine:

- Whether you used the correct tax rate (for sales shipped into or out of special tax districts, see our auditor for help). All the rates in Colorado are listed in DOR publications DR1002, *Colorado Sales/Use Tax Rates* and DRP 1250, *History of Local Sales and County Lodging Taxes*, available on our website at http://www.revenue.state.co.us/TPS_Dir/home.asp, or from taxpayer service at 303-238-SERV (7378) (see page 11).
- Whether you properly calculated the tax amount (check against your sales tax table or calculate the amount of tax due with a calculator).

You should also check the invoice to make sure that you added an amount for tax to all taxable charges and did not add an amount for tax to nontaxable charges. The publications provided by your auditor should help you identify common nontaxable charges. If you're not sure how tax should apply to a transaction, contact our auditor.

If you find that your invoice lists either too much or not enough tax, you must enter information from the invoice on the blank worksheet provided by our auditor.

If you did not add an amount for tax to all or part of the sale:

If the invoice shows that you did not add an amount for tax to all or part of your charges, you must take these three steps:

- Enter information for the transaction on the sales worksheet provided by our auditor.
- Check your records to see if you have documents that support your decision not to add an amount for tax (auditor provided information may help with this).
- Note the type of document in the comment column of the worksheet (for example: *resale number*). If you do not have a customer-provided document on file, note the reason tax does not apply (for example: *repair labor*).

Sales for resale

You should have a timely and valid resale number on file for customers who make resale purchases. In general, each sale should indicate whether the customer's purchase was for resale or whether it was taxable. If the sale includes items to be resold *and* items to be used, it should specify which items are being purchased *for resale* and which are being purchased for use. You must list on your transaction worksheet all transactions for which you did not add a tax amount to all or part of the sale. If in verifying a transaction you find that you do not have a valid resale number on file or that you do not have other adequate support documents in your records, it may be necessary to take additional steps, such as contacting the customer for additional information.

Accepting a valid resale number **in good faith** from your customer at the time of a sale relieves you of responsibility for the tax that would otherwise be due. You must retain resale numbers as part of your records. See FYI' Sales 1, 3 and 63.

Verification of license and exempt numbers

The Department of Revenue provides 24-hour, seven day a week, automated service for those wanting to verify a Colorado sales tax or sales tax exemption number for a specific business or organization. This service determines whether a Colorado sales tax license or state sales tax exemption certificate is valid.

Web site users may use this online system at: WWW.taxview.state.co.us

Be sure to set aside your support documents for our auditor to review.

Completing your sales verification worksheet

Our auditor will provide you with paper or electronic transactions worksheets on which you'll enter information for the sales identified earlier in this section.

As you complete your sales worksheet with information from your actual invoices, you may find that you have questions that are not addressed in this guide or that you're not sure exactly what information to include. Contact our auditor if you need more help.

Be sure to keep all listed invoices and related records available for our auditor's review.

3. Reviewing your purchases

During an audit, our auditor would typically examine your purchase invoices to determine whether you

- Properly added tax to your purchase transaction.
- Correctly calculated the tax amount.

In a managed audit, you may perform these tasks yourself. If you find that sales tax was not properly added or use tax calculated on a purchase, you will enter information from your invoice on a purchase worksheet provided by our auditor.

Before you begin your review, you may wish to read the "Reminder" section below, which provides a short explanation of how sales and use tax applies to purchases. You may also wish to refer to the information provided by our auditor for guidance regarding nontaxable purchases.

Assembling your records for review

Our auditor will indicate in the MAP Participation Agreement which records you will review in the managed audit, as well as the test period and method you will use.

Reminder: How tax applies to your purchases

While your purchases for resale are not taxable, your purchases of items that you *use* rather than sell or hold for sale in your business are generally subject to sales or use tax. Common examples include purchases of business furniture, machinery, and office equipment and supplies (unless you normally sell these products in your business). The tax rate that applies will in part depend on the vendor location and whether the goods were delivered or picked up.

Tax must be paid directly to the Department on certain types of purchases, based on the price paid for the merchandise. You must generally report tax on your sales or use tax returns if you

- Purchase an item for resale and then make business or personal use of the item before selling it or instead of holding it for sale (reportable on line 10 of the sales tax return), or
- Purchase an item from a vendor without tax charged and use it in your business or for personal use. (reportable on a consumers use tax return, DR 252.)

Colorado retailers will generally add an amount for sales tax to your purchase unless you issue them a valid resale number.

Note: Tax rates in this publication may not be current. Be sure to use the correct rates in your audit. Please see DOR Forms DRP 1002, Colorado Sales/Use Tax Rates, and DRP 1250 History of Local Sales and County Lodging Taxes for the proper sales/use tax rates.

Reviewing your purchase invoices

Our auditor will specify in the MAP Participation Agreement which invoices you must review as part of your managed audit, and provide printed or electronic transaction worksheets for your use. You must review each invoice and make sure that you paid tax when it was due and that you paid the correct amount (see previous section). Be sure to check the amount of tax by using a tax rate table for the rate in effect at your location. You should also check to see whether you paid another state's tax on the transaction, or whether you paid use tax on the purchase on your sales or use tax return.

You must list information for a purchase on your purchase transaction worksheet if you find that you did any of the following:

- Overpaid or underpaid sales or use tax.
- Did not pay tax to your vendor but did pay use tax on the purchase on your sales or use tax return.
- Paid Colorado sales or retailers use tax to an out-of-state seller.
- Paid another state's tax on the purchase.

Completing your purchase worksheet

As you complete your worksheet with information from your own purchase invoices, you may find that you have questions that are not addressed in this guide or that you're not sure exactly what information to include. Contact our auditor if you need more help.

Be sure to keep all listed purchase invoices and related records available for our auditor's review.

4. Finishing up the audit

When you're done with your portion of the work, our auditor will review and verify your sales and purchase worksheets, support documents, and invoices. When the review is complete, the auditor will arrange to hold an exit conference with you. If you prefer, you may be represented by another person or bring a representative with you. Our auditor's supervisor may also attend the conference. At the conference, the auditor will explain any proposed credits, refunds, or additional tax resulting from the audit, or let you know that your returns have been accepted as filed.

Notice of final audit results

Our auditor will prepare a *Summary of Audit Adjustments* that summarizes the audit findings. (You will receive a copy of the *Summary*, which is *not* a billing or refund). We will issue a billing (*Notice of Deficiency*), a refund (*Notice of Refund*), or a letter indicating that you do not owe additional tax. Refunds and deficiency notices are sent certified mail.

If you disagree with the audit results, you may appeal pursuant to the procedure set forth in section 5 of this guide.

Notice of Deficiency

If you receive a *Notice of Deficiency* indicating that you owe additional tax, please take care to note its issue date. Within 30 days of that date, you must either pay the billed amount, or if you disagree with the report and notice, file a protest. If you do not take either action within that time period, you will be assessed a penalty and penalty interest. If you continue not to pay the billed amount, we may take collection actions, including filing liens or levies. In addition, if you do not pay on time, we may void your Managed Audit Program Agreement.

Important: Interest continues to accrue until you pay all tax due. If you disagree with the results of your audit, you may want to pay the amount shown on the *Notice of Deficiency* to stop the accrual of interest, then *file a protest per section 5 below*. If you need to make payment arrangements, please contact the compliance section at 303-866-3935. Our auditor cannot accept tax payments.

Notice of Refund

Before any refund can be issued, our staff must first determine whether you have an outstanding liability with the Department or any other state agency. If you do have such a liability, we may be required to transfer enough of the refund amount to cover it. In addition, refunds over \$1,000,000 must be approved by the *Executive Director* of the

Department of Revenue. For other approved refunds, the Department normally mails the *Notice of Refund* and a check for the refund amount about four to eight weeks after the audit is processed. Refunds are mailed by certified mail and interest is paid from the date of overpayment pursuant to C.R.S. 39-21-110.

If you disagree with the audit results, you may file a written protest per step 5 below.

5. Protesting the results of your audit

Participation in a managed audit does not change your right to protest the audit results.

TAXPAYER'S RIGHT TO PROTEST AUDIT DETERMINATIONS:

Section 39-21-103(2) C.R.S.: The taxpayer will receive by mail a complete set of work papers prepared by the auditor, along with a Notice of Deficiency. This Notice of Deficiency will include the proposed adjustments and all interest and penalties assessed. Taxpayers have the right to protest all or part of a Notice of Deficiency. Protests are filed by requesting a hearing before the executive director of the Department of Revenue within 30 days of the date on the Notice of Deficiency. This 30-day period is set by statute and cannot be extended. The request for hearing must contain the information called for on the reverse side of the Notice of Deficiency. If the adjustment and interest are not paid or protested within the 30-day period allowed a Notice of Final Determination and Demand for Payment will be sent. Interest accrues on all protested taxes not remitted. Interest discount is allowed upon payment of the tax and interest on or before the due date of the Notice of Deficiency. The discount will not be allowed on any tax and interest remitted after the due date. A Notice of Refund may be protested as well.

For more information regarding your protest rights and the protest process, please consult with your auditor.

6. For more information

For help with your managed audit, please contact your DOR auditor. For answers to general tax information questions not related to your audit, please call TAXPAYER SERVICE 303-238-7378.

You may download publications and regulations from our website:

http://www.revenue.state.co.us/TPS_Dir/home.asp

Written Tax Advice

For your own protection, it is best to get tax advice in writing. You may be relieved of penalty, or interest charges that are due on a transaction or activity if we determine that you reasonably relied on incorrect written advice from us regarding the transaction or activity. For this relief to apply, a request for advice must be in writing, identify the taxpayer to whom the advice applies, and fully describe the facts and circumstances of the transaction. Please send your request to the Colorado Department of Revenue, Taxpayer Service Division, Room 205, 1375 Sherman Street, Denver, CO 80203.

Taxpayers' Rights Advocate

If you have been unable to resolve a disagreement with the Department or would like to know more about your rights under the Sales and Use Tax Law, please contact the Governor's Advocate, Diane Webb, 303-866-4622.

Field Offices

Denver 303-355-0400
Colorado Springs 719-594-8708
Fort Collins 970-494-0932
Grand Junction 970-248-7138
Pueblo 719-542-2945

For Out-of-State Accounts

San Francisco 415-781-0508
New Jersey 201-541-8432
Dallas 214-623-0374

NAME _____
 ACCOUNT _____

This is a Managed Audit Program (MAP) Participation Agreement between the Colorado Department of Revenue and _____ (taxpayer)
TAXPAYER'S NAME

in accordance with C.R.S. 39-26-116.

1. For the managed audit to be conducted under the MAP for the period beginning on _____ and ending on _____, the taxpayer represents that
DATE DATE
 - The taxpayer's business involves few or no statutory exemptions and a single or a small number of clearly-defined taxability issues, and
 - The taxpayer agrees to participate in the MAP and has the resources to comply with the managed audit instructions provided by the Department.

2. The taxpayer shall complete the managed audit on or before _____ in accordance with the instructions in this agreement. The taxpayer shall make available to the DOR by this date all computations, all transaction worksheets (as described in paragraph 3 below), and all books, records, and equipment relating to the managed audit for verification by the Department.

3. The types of transactions covered by this managed audit are listed in Section 1 of the Appendix of this agreement. In performing the managed audit, the taxpayer shall
 - Review and separately maintain for verification by the Department the books, records, and equipment specifically identified by the Department in Section 2 of the Appendix,
 - Follow the specific procedures listed in Section 2 of the Appendix to determine the amount of the unreported tax liability, if any,
 - Schedule the transactions relating to each of the books, records, and equipment identified in Section 2 of the Appendix by completing transaction worksheets provided by the Department, in accordance with the instructions in DOR PUBLICATION, Guide to the Managed Audit Program, a copy of which has been given to the taxpayer, and
 - Follow the special instructions (criteria), if any, described in Section 3 of the appendix.

4. When the taxpayer has completed the managed audit, the Department may verify the results of the managed audit by reviewing the documents prepared by the taxpayer, by examining the books, records, and equipment of the taxpayer, and by taking any other necessary actions to verify the results of the managed audit, including requesting further information and documentation from the taxpayer.

5. If the Department determines that certain types of transactions should be audited by the Department and not by the taxpayer under the MAP, the Department shall notify the taxpayer either during or after the managed audit which types of transactions will be reviewed by the Department and what books, records, and equipment the Department must examine. If the Department determines that an unreported tax liability exists for those types of transactions which the Department audits pursuant to this paragraph, the interest rate set forth in paragraph 7 shall apply with respect to that liability unless the Department voids this agreement pursuant to paragraph 10.

6. Upon completion of the managed audit by the taxpayer, the verification of the managed audit by the Department, and the audit by the Department of transactions not audited under the MAP, an additional liability, if any, may be determined and a notice of

deficiency issued by the Department and protested by the taxpayer under C.R.S. 39-21-103. If the notice of deficiency is not paid or protested within 30 days of mailing of the notice of deficiency, a Notice of Final Determination and Demand for Payment, including the penalty and penalty interest previously waived by the MAP agreement, will be issued. The Notice of Final Determination may be appealed under C.R.S. 39-21-105.

7. Upon completion of the managed audit and verification by the Department, interest shall be computed as provided for in C.R.S. 39-21-109. Penalty and penalty interest provided for in C.R.S. 39-26-115, 39-26-118, 39-26-207, 39-26-204, and previously waived by execution of the Managed Audit Program Participation Agreement, may be imposed if a Notice of Deficiency issued as a result of the Managed Audit, is not paid or protested within 30 days of the mailing of the notice of deficiency.
8. As provided in C.R.S. 39-26-116, the information provided by the taxpayer shall be the same information required for the completion of any other audit that the Department may conduct.
9. Nothing in this agreement shall limit the Department's authority, under 39-26-116, to examine the taxpayers' books, records, and equipment. Nothing in this agreement shall limit the authority of the Department to determine an unreported tax liability or a refund or credit greater than or less than the unreported tax liability or refund or credit computed by the taxpayer in the managed audit.
10. The Department may void this agreement if the Department determines that
 - The taxpayer has failed to complete the managed audit by _____ in accordance with the provisions in this agreement,
 - The taxpayer has refused to cooperate with the Department during the verification process described in paragraph 4 above or has refused to cooperate with the Department if the Department audits any transactions as provided in paragraph 5 above,
 - Any of the penalties under sections 39-21-118, 39-26-115, 39-26-118, 39-26-120, & 39-26-206 C.R.S. should be imposed during the audit period,
 - There is jeopardy of collection under section 39-21-111 C.R.S., or
 - The taxpayer has not paid the tax and interest resulting from the managed audit (1) within 30 days of the issuance date of the related Notice of Deficiency or (2) as agreed upon in a formal installment payment agreement.

If the Department determines that this agreement should be voided, the Department shall notify the taxpayer in writing. If the Department voids this agreement, in addition to tax and interest, penalty and penalty interest may apply. In addition, the Department may proceed to examine the taxpayer's books, papers, records, and equipment in a manner to be determined by the Department, and any liability may be determined and collected by the Department and subsequently protested by the taxpayer under C.R.S. 39-21-103.

11. The Department has given the Guide to the Managed Audit Program to the taxpayer for instructional purposes. If there is a conflict between that publication and the Sales and

Use Tax Law or this agreement, the Sales and Use Tax Law and this agreement shall control.

SIGNATURE (name of taxpayer)

DATE

NAME/TITLE (print full name and title)

(For corporations an officer with authority to bind the corporation must sign; for partnerships, a general partner must sign; and for sole proprietorships, the owner must sign)

SIGNATURE (Department of Revenue Chief Auditor)

DATE

NAME/TITLE (print full name and title)

APPENDIX
Managed Audit Program Participation Agreement

NAME _____ ACCOUNT NUMBER _____

AUDIT PERIOD
From _____ To Month Day Year _____

SECTION 1

The types of transactions to be audited by the taxpayer are checked below:

- | | |
|--|-------------------------------|
| Sales for Resale | Installation Labor |
| Sales of Property Shipped Outside Colorado | Repair Labor |
| Shipping and Delivery Charges | Cash Discounts |
| Sales to the United States Government | Property Purchased For Resale |
| Purchases from Out-of-State Vendors | |
| Other: | |

SECTION 2

The books, records, and equipment that are to be reviewed by the taxpayer are checked below:

- | | |
|---------------------|--|
| Sales Invoices | Freight Bills |
| Sales Contracts | Other Shipping or Delivery Documentation |
| Resale Certificates | Purchase Orders |
| Bills of Lading | Purchase Invoices |
| Other: | |

The procedures to determine the amount of any unreported tax liability are described on pages 4 through 11 of the Guide to the Managed Audit Program. The taxpayer will be reviewing the books, records, and equipment checked above for the following periods:

TEST PERIODS

Period 1 _____ Period 2 _____ Period 3 _____ Period 4 _____

Description of method for review:

SECTION 3

Special Instructions (Criteria):

None

Other: _____

SIGNATURE (name of taxpayer) DATE

NAME/TITLE (print full name and title)

SIGNATURE (Department of Revenue Chief Auditor) DATE

NAME/TITLE (print full name and title)
