

NOTE: The following penalties have changed effective with the 3rd quarter 2014 -

- Late Filing - A penalty of 15% (10% for periods prior to the 3rd quarter 2014) plus interest will be charged.
- Late Deposit - A penalty of 15% (10% for periods prior to the 3rd quarter 2014) plus interest will be charged.
- Wage Item Penalty - A wage item penalty of \$20 (\$10 for periods prior to the 3rd quarter 2014) per employee will be charged for late reporting or unreported employee wages.

TAX AUDIT GUIDELINES

TAX AUDIT GUIDELINES

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TAX AUDIT GUIDELINES

CHAPTER I

AUDIT PROGRAM

A. OPERATIONAL STRUCTURE AND MISSION

1. Tax Branch Mission

The Tax Branch operates a fair, efficient, and effective employment tax system. We are committed to providing excellent service to employers and claimants, and to increasing voluntary compliance with employment tax laws through education, simplified reporting processes, and the promotion of fair business competition.

2. Tax Branch Structure

The Tax Branch of the Employment Development Department (EDD) is comprised of five divisions: Tax Support Division (TSD), Tax Processing and Accounting Division (TPAD), Insurance Accounting Division (IAD), Collection Division (CD), and the Field Audit and Compliance Division (FACD).

B. FACD Mission

FACD plays an important role in supporting the mission of the Tax Branch.

The mission of FACD is to operate an effective process of education, assistance, and enforcement to promote compliance within the employment tax system administered by Tax Branch.

This mission is fulfilled through the administration of the following three integrated programs designed to address various levels of non-compliance found within the employer community.

- **Customer Service Program**

The Customer Service Program provides front-line advisory service to all employers throughout California. In addition, the Customer Service Program conducts new employer workshops to help educate the employer community on issues that affect their payroll reporting requirements. Within the Customer Service Program, Employment Tax Consultants provide personalized consultations to new businesses so they can avoid prolonged non-compliance, which often leads to large unplanned tax liabilities.

- **Audit Program**

The Audit Program examines all types of business entities to determine their level of compliance with the California Unemployment Insurance Code (CUIC) and works with employers to ensure long-term compliance.

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Chapter I

- Underground Economy Operations Program

The Underground Economy Operations (UEO) focuses on detection of the most non-compliant employers, including those who pay unrecorded cash wages or participate in schemes to evade their tax responsibilities.

1. FACD Central Operations

FACD Central Operations provides technical support to the entire division. Audit Section and Technical Support Section are located within FACD Central Operations. Audit Section consists of Product Development Group and Quality Assurance and Petition Review Group. Technical Support Section consists of Information Management Group, Research and Status Group, and Technical Training Group.

TAX AUDIT GUIDELINES

CHAPTER II

TAX AUDITOR AUTHORITY, DUTIES, AND RESPONSIBILITIES

A. AUTHORITY

1. Executive Orders

The Tax Branch delegations are contained in the Department's Executive Orders.

Executive Order No. 12 provides the authority for specified employees to administer oaths and issue subpoenas under the CUIA. The order provides that pursuant to the CUIA and California Government Code Sections 11180-11182, certain officers and employees are authorized to administer oaths. Within FACD, the following employees may administer oaths:

- Chief, Field Audit and Compliance Division
- Assistant Chief, Field Audit and Compliance Division
- Chief, Central Operations, Field Audit and Compliance Division
- Any employee designated as Regional Audit Program Manager, Assistant Regional Audit Program Manager, or Area Audit Manager
- Chief, Underground Economy Operations
- Program Manager, Customer Service, Field Audit and Compliance Division
- All Tax Compliance employee's at the level of TCR or above
- All Tax audit employees at the level of Tax Auditor II or above:

In addition, the following division staff are authorized to issue subpoenas to compel attendance of witnesses and the production of books, papers, correspondence, memoranda, and other records:

- Chief, Field Audit and Compliance Division
- Chief, Underground Economy Operations
- Assistant Chief, Field Audit and Compliance Division
- Chief, Central Operations, Field Audit and Compliance Division
- Program Manager, Customer Service, Field Audit and Compliance Division
- Assistant Program Manager, Customer Service
- Any Underground Economy Operations Section Chief at the Tax Administrator II level
- Any Central Operations, Field Audit and Compliance Division, Section Chief, at the Tax Administrator II level.
- Any manager at the level of Tax Administrator I or above designated as Audit Program Manager, Assistant Audit Program Manager, Area Audit Manager, or Supervising Tax Auditor

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Chapter II

Executive Order No. 20 provides the authority for specified employees to require records, reports, returns, and contributions from employers. The information is furnished pursuant to CUIA sections 1085-1088, 1092-1093, 13043, and 13050.

The following FACD employees are authorized to require this information from employers:

- Chief, Field Audit and Compliance Division.
- Assistant Chief, Field Audit and Compliance Division.
- Regional Audit Program Manager.
- Area Audit Program Manager.
- Any Tax Administrator.
- Any Supervising Tax Auditor.
- Any Tax Compliance Representative I or above.
- Any Auditor.
- Any Program Technician or Program Technician II.

2. Authority under the California Government Code

The following sections of the California Government Code gives the auditor the authority to access records:

- Section 11180 provides that the head of each department may make investigations and prosecute actions concerning all matters relating to the business activities and subjects under the jurisdiction of the department. This includes matters involving violations of any law or rule of the department and any such other matters as may be provided by law.
- Section 11181 provides that the department head may inspect books and records, hear complaints, administer oaths, certify to all official acts, issue subpoenas, and divulge evidence of unlawful activity discovered.
- Section 11182 authorizes the Director to delegate the powers conferred by the California Government Code to any officer of the Department authorized to conduct the investigation.

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3. Authority under the CUIIC

Authority in the CUIIC has been delegated to field staff as follows:

- CUIIC Section 301 provides that EDD is vested with the duty of making assessments and the administration of credits and refunds.
- CUIIC Section 311 authorizes the Director of EDD to appoint assistants and subject to the provisions of the California Government Code, may delegate functions to officers or employees.
- CUIIC Section 317 requires the Director to maintain a field investigating staff, whose function shall embrace investigation throughout the state of violations of the CUIIC, to the end that its provisions are more adequately and strictly enforced.
- CUIIC Section 13000 provides that the Department shall have the powers and duties necessary to administer the reporting, collection, refunding to the employer, and enforcement of taxes required to be withheld by employers pursuant to CUIIC Section 13020.
- CUIIC Section 13020 provides that:
 - a) Every employer who pays wages to a resident employee for services performed either within or without this State, or to a nonresident employee for services performed in this State, shall deduct and withhold from such wages, except as provided in CUIIC Sections 13025 and 13026, for each payroll period, a tax computed in such manner as to produce, so far as practicable, with due regard to the credits for personal exemptions allowable under Section 17054 of the Revenue and Taxation Code, a sum which is substantially equivalent to the amount of tax reasonably estimated to be due under Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code, resulting from the inclusion in the gross income of the employee of the wages which were subject to withholding. The method of determining the amount to be withheld shall be prescribed by the Franchise Tax Board pursuant to section 18806 of the Revenue and Taxation Code.
 - b) The Department, upon request, may permit the use of accounting machines to calculate the proper amount to be deducted and withheld from such wages, if such calculation produces an amount substantially equivalent to the amount of tax required to be withheld under CUIIC Section 13020(a).

B. Auditor Responsibilities

The auditor has the following specific responsibilities:

- The auditor will be responsible for making the initial determination as to status and tax liability, and will cite any specific authority used.
- The auditor will advise the employer of the initial determination.
- The auditor will determine the tax liability for the period under review.
- When the basis for a credit has been established and verified, the auditor will recommend allowance of the credit.
- The auditor will conduct an exit interview.

C. Rules of Conduct

1. Department Representative

Generally, the auditor is the only representative of EDD who contacts the employer at the employer's place of business. The auditor will attempt to establish a good relationship with the employer and staff.

2. Inform the Employer

The auditor will acquaint the employer with the provisions of the programs administered by EDD as well as its rules and regulations.

The auditor will not express any advice or opinions about any law except the CUIC.

3. Objectivity

If the employer disagrees with the audit findings, the auditor will discuss the differences and explain the reasons for the findings. If the employer still disagrees, the auditor will suggest that additional discussions be held with the auditor's immediate supervisor.

4. Confidentiality

The right to examine the financial records of an employer carries with it a responsibility to keep all information obtained strictly confidential. Auditors may be held personally liable for disclosure of confidential information.

When an EDD representative is initially requested to provide information either verbally or in writing, that representative shall issue the Information Collection and Access Form, DE 8445.

5. Gratuities

The acceptance of gratuities is prohibited by the State of California. Any gratuity, gift, or tip inadvertently received in the course of duty must be returned to the donor, if known. If the donor is unknown, the auditor should turn the gratuity, gift, or tip over to the immediate supervisor for disposition.

6. Disclosure of Facts

It is the auditor's responsibility during an assignment to disclose all relevant facts with respect to the auditor's determination. The auditor will include in the audit report all facts, both those that favor the auditor's determination, as well as those that favor the employer.

7. Conflict of Interest

The auditor must inform his/her supervisor of any possible conflict of interest that he/she may have with the employing unit, employer, employer's representative, etc. If the employer is, for example, a friend, relative, or business acquaintance, then the audit would normally be reassigned.

8. Incompatible Activities

Pursuant to Government Code Section 19251, EDD employees may not participate in employment activities or enterprises which are inconsistent, incompatible, or in conflict with the duties of State employees, or with the duties, functions, and responsibilities of EDD.

9. Auditor's Liability

Government Code Section 860.2 describes situations in which public employee's are not liable for injury when performing his or her duties. Government Code Section 860.2 states that neither a public entity nor a public employee is liable for injury caused by:

- Instituting any judicial or administrative proceeding or action for or incidental to the assessment or collection of a tax.
- An act or omission in the interpretation or application of any law relating to a tax.

Government Code Section 860 defines tax for purposes of 860.2 as a tax, assessment, fee, or charge.

D. Employer Responsibilities

1. Record Keeping Requirements

Title 22 of the California Code of Regulations (CCR) and the CUIC provide authority pertaining to the responsibilities of employers, as well as those businesses which do not believe they are employers. Employers are required to:

- **Maintain Records**

CUIC Sections 1085 and Title 22, CCR Section 1085-2 require employers to keep a true and accurate work record for all workers including wages paid to each worker and such other records as the Director may require.

Title 22, CCR Section 1085-5 states that all employers, as well as businesses which do not believe they are employers, shall keep and maintain records required of employing units. This section places the burden of proof on a business to show that it is not an employing unit by producing appropriate and relevant records.

CUIC Section 1088 requires that the employer shall file with the Director, within the time required, a return and report of wages. The required form and information must contain such information as the Director prescribes.

- **Make Records Available**

CUIC Section 1092 requires that employer records shall be open to inspection by EDD representatives at any time during normal business hours of the employing unit.

CUIC Section 2105 states that it is a violation for any employing unit or any officer or agent of an employing unit to willfully and unlawfully fail or neglect to make available required records for the inspection of the Director or the Director's authorized representative at any reasonable time during business hours.

TAX AUDIT GUIDELINES

CHAPTER III

CASE ASSIGNMENTS

A. TYPES OF ASSIGNMENTS

- Determine and verify by calendar quarter the amount of taxable wages paid or payable and the amount of contributions, interest, and penalties required under the CUIC.
- Determine if the employing unit has made the proper withholding for State personal income tax as required by the CUIC and has accurately reported the withholding to EDD.
- Resolve obstructed benefit claims.
- Resolve wage-earner claims for refund under CUIC Section 1176 or proof of credit variances.
- Establish liability under bankruptcy, probate, and assignment for benefit of creditors actions.
- Assist other states in resolving discrepancies in reporting to their state.
- Enforce correct reporting in industries known to be incorrectly reporting or not reporting specific wages or services.
- Follow up leads furnished by other Area Audit Offices, the public, or other offices within EDD.
- Follow-up audits furnished by UEO.
- Assist compliance staff in reconciling Tax Automated System (TAS) generated estimated assessments issued for failure of the employing unit to file returns.
- A worker furnishes a DE 230 as a potential employment tax audit lead and it is forwarded by Audit Section to the appropriate AAO, ETCSO, or in certain situations to UEO.

B. CASE ASSIGNMENT GUIDELINES

Each case will be inspected and analyzed when received or initiated in the AAO.

1. Field Assignment (DE 106)

Form DE 106 will be prepared by the initiator of the assignment. The DE 106 will state the purpose, nature, and extent of the assignment.

The information to be shown in the heading and at the bottom of the DE 106 is self-explanatory. In the body of the form:

- Clearly state the reason for the assignment;
- Set forth in detail the nature of the discrepancy and/or controversy involved;

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Chapter III

- Indicate the information which is to be determined or verified;
- Include any additional facts which would assist in completing the assignment, i.e., recent correspondence, etc.;
- Include a chronological history of employer contacts;
- Indicate the date field work first began; and,
- Indicate the date the assignment was completed and sent to review.

However, if another document contains the basic data for initiating an assignment, it may be attached to the DE 106 with a note on the DE 106 referencing the other document.

The Assignment File Control sheet from the FACD IS may be used in lieu of the DE 106 for all assignments.

2. Attachments

Previously completed audit reports, working papers, schedules, and/or correspondence will be attached to a new assignment.

C. CASE SET UP

1. Inquiry Regarding Records (DE 996)

The employer will be mailed a DE 996. A DE 996D, DE 996Q, and Information Sheet for Business-The Employment Tax Process (DE 231TA), should be enclosed with the DE 996. A follow-up of fifteen days should be established for each letter.

The DE 996 provides:

- Name, address, and account number of the account to be audited.
- The purpose for the audit and the period to be audited.
- An area for the employer to indicate when the records will be available, who to contact for the appointment, and their phone number. This lower section of the form may be removed by the employer and returned to the AAO.

2. Audit Appointment (DE 996C)

The DE 996C informs the employer of the date and time the auditor will appear at the employer's place of business to conduct an audit. If the appointment is not convenient, the employer has the option of rescheduling.

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3. Form DE 996D

The DE 996D lists the types of books and records that the auditor may need to examine during the course of the audit.

This form is usually attached to the DE 996 or DE 996C.

D. TRANSFERRING AN ASSIGNMENT

1. Introduction

An assignment is normally transferred when it is determined that the employer is no longer located within the AAO's area or the assignment is sent to an incorrect AAO.

2. Contact Transferee AAO

Instead of immediately transferring the assignment, the authorized employee may contact the other AAO to determine whether or not it would be beneficial to transfer the assignment.

E. CASE APPOINTMENTS

1. Appointment Scheduling

In general, most audit appointments are made in advance. Audit appointments will be scheduled for a future date, normally after the DE 996 is received back from the employer. In some cases, the employer will call the AAO after receipt of the DE 996 to schedule the appointment. Appointments may be made by letter, telephone, or in person. The employer will be given time to assemble the books and records to be examined.

In order to set an appointment date, time, and place, the auditor can telephone the employer representative listed on the DE 996. The call should cover the following points:

- The reason for the call.
- The purpose of the audit.
- Make reference to the DE 996D for possible records needed.
- Request that the employer or authorized representative be available during the audit.

TAX AUDIT GUIDELINES

CHAPTER IV

DEFINITIONS AND CLASSIFICATIONS OF AUDITS

A. DEFINITION OF AN AUDIT

1. Definition

An audit is a systematic examination and verification of a subject employer's books and records, conducted in accordance with auditing standards and procedures. EDD conducts both full audits and status audits.

2. Purpose of an Audit

The purpose of an audit is to:

- Promote voluntary compliance.
- Verify that a subject employer has complied with the laws and regulations enforced by EDD.

B. CLASSIFICATION OF AUDITS

1. Verification vs. Request

The United States Department of Labor requires that audits be classified as either verification or request audits. Verification audits are initiated based on a random selection of subject employers or other established selection criteria. Request audits are conducted based on some knowledge of a need for an audit for a particular subject employer.

2. Verification Audit Assignment

Verification audit assignments are usually based on no previous knowledge of a specific subject employer. An employer is selected for audit based on:

- Size of the payroll
- Numbers of workers
- Geographic location
- Type of industry
- Liability within a specified time frame, or
- Any combination of the above.

3. Request Audit Assignments

Request audits are conducted because of an identified or suspected need to audit a specific subject employer. This type of audit is normally initiated as a result of a benefit, status, or delinquency assignment.

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TAX AUDIT GUIDELINES

CHAPTER V

SUBPOENAS

A. SUBPOENAS - OVERVIEW

1. Types

EDD issues administrative *Subpoenas/Subpoenas Duces Tecum* (DE 297) under the authority of Sections 11180 and 11181 of the California Government Code. (Executive Order No. 12.)

2. Definition of Subpoena

An administrative *subpoena* is a writ or order issued by EDD directed to an individual. It requires attendance at a particular time and place to testify as a witness before an authorized Department officer or employee.

3. Use of Subpoena

An administrative *subpoena* may be used by EDD to require an individual to appear at an AAO in order to give a signed affidavit.

4. Definition of Subpoena Duces Tecum

An administrative *subpoena duces tecum* is a writ or order issued by EDD directed to an individual. It requires an individual to produce specified books, documents, or any other items within their control at a particular time and place before an authorized EDD officer or employee.

5. Use of Subpoena Duces Tecum

An administrative *subpoena duces tecum* may be used by EDD to obtain books and records which the employer, or other custodian of the books and records, has not made available.

Special Note: Only the Appeals Board has the authority to require attendance by a witness or production of records at a tax or benefit hearing before an Administrative Law Judge (CUIC Sections 407 and 1953; Title 22, California Code of Regulations, Section 5058). The Appeals Board will issue the subpoenas needed, at the request of EDD.

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B. PREPARATION AND SERVICE OF A SUBPOENA/SUBPOENA DUCES TECUM (DE 297)

A *subpoena* or a *subpoena duces tecum* is issued using the form DE 297. The preparer will complete the following steps:

- Complete DE 297 in duplicate,
- Properly identify the employer/individual to whom the *subpoena* or *subpoena duces tecum* will be issued,
- Properly identify/describe the books and records required (if applicable), and
- Forward the form to the Area Audit Program Manager for approval and signature.

1. Addressing and Serving the Subpoena

The *subpoena* or *subpoena duces tecum* will correctly identify the individual and/or business being served, and will be correctly served. The following chart describes the proper procedures:

ENTITY	DIRECTIONS	EXAMPLE
Individual/Sole Proprietorship	If individual uses a business name, both names will be entered.	"A" individually and doing business as "X" Company.
Limited Partnership	In the case of a limited partnership, service will not be made on a limited partner <u>until</u> it is determined that the limited partner has possession of the records.	Same as General Partnership.

Chapter V

1. Addressing and Serving the Subpoena (cont.)

ENTITY	DIRECTIONS	EXAMPLE
<p>General Partnership</p>	<p>Service will be made on the partnership. One of the partners will be served first as an individual and secondly as a partner of the partnership.</p> <ul style="list-style-type: none"> Two copies of the subpoena will be given to the partner. <p>If further service is desired, it may be made on the individual partners doing business as a partnership.</p> <ul style="list-style-type: none"> Only one copy of the subpoena needs to be given. 	<p>"A and B are partners, doing business as X Company."</p> <p>Serve:</p> <p>"A, individually and as a partner, doing business as X, a partnership."</p> <p>"X, a partnership, by serving A, a partner."</p> <p>"B, individually and as a partner, doing business as X, a partnership."</p>

Chapter V

1. Addressing and Serving the Subpoena (cont.)

ENTITY	DIRECTIONS	EXAMPLE
Corporations Domestic and Foreign	<p>Service must be made on the officer, agent, or other individual who has possession or control of the books and records for the domestic or foreign corporation.</p> <p>DE 297 will be directed to the individual who has actual possession of the desired records. If this individual is other than the officer of the corporation, address it to the individual.</p>	<p>If the individual is an officer of the corporation, indicate on the books and records for the domestic or foreign corporation.</p> <p>"To J. H. Smith"</p>
Receiverships	A receiver will be served individually and as a receiver.	"J. Jones, individually and doing business as receiver of the XYZ Corporation.
Bankruptcy	A trustee for a bankrupt employer is similarly served.	"J. Jones, individually and doing business as Trustee in Bankruptcy of the XYZ Corporation.
Executor or Administrator	An executor or administrator of an estate is served individually and as a representative of the decedent.	"J. Jones, individually and doing business as Executor of the Estate of Tom Smith Decedent."

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Chapter V

2. Identification of Records

The preparer of the DE 297 should describe the books and records that are to be produced in the space provided on the form. The preparer may use the records, reports, etc., listed on form DE 996D as a guide, with the exception of State and Federal income tax returns. Judicial precedent precludes EDD from requiring an individual or employer to produce income tax returns for EDD inspection.

3. Extension of Time

If an EDD representative allows the individual subpoenaed an extension of time, or if the date of appearance is changed, another *subpoena/subpoena duces tecum* will be prepared. Changes to the original DE 297 may make the *subpoena/subpoena duces tecum* unenforceable.

4. Who Will Serve the Subpoena?

EDD personnel will generally serve a *subpoena*. However, there may be circumstances under which it is advisable to have the service made by a law enforcement officer.

5. Affidavit and Subpoena

Some law enforcement agencies may insist on an affidavit before serving a *subpoena* by citing Section 1987.5 of the Code of Civil Procedures. Section 1987.5 requires an affidavit in support of a *subpoena/subpoena duces tecum*. This section refers to civil law, not administrative law. EDD authority for issuing *subpoenas* rests with Section 11181 of the California Government Code and CUIIC Section 311. Neither code section requires an affidavit.

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Chapter V

C. FAILURE TO APPEAR

If either the employer or another individual who was served with a *subpoena/subpoena duces tecum* fails to appear at the time and place specified, or fails to produce records within the specified time limit, the AAO will take the following actions:

STEP	ACTION
1	Complete an affidavit of service.
2	Prepare a typed report (DE 16) specifying: <ul style="list-style-type: none">• The date(s) on which the employer was served.• The nature of each conversation that took place.• Note - The report will be a detailed factual statement that may be referred to Legal Section and the Attorney General.
3	Send the completed original <i>subpoena/subpoena duces tecum</i> , and the typed report (DE 16) to Audit Section, MIC 94.

Chapter V

1. Audit Section Responsibility

Upon receipt of the DE 16 report and completed *subpoena/subpoena duces tecum*, Audit Section will:

STEP	ACTION
1	Review the report.
2	Prepare a transmittal letter addressed to Legal Office.
3	Send the report, <i>subpoena</i> and transmittal to Legal Office, MIC 53. Legal Office will forward it to the Attorney General. Send a copy of the transmittal to the AAO manager.

2. The Next Step

In most cases, the Attorney General will write a letter to the employer. If the employer fails to make satisfactory arrangements after receipt of the letter, the Attorney General may ask the Superior Court for an order to the employer to show cause why the employer should not be held in contempt of court. Failure to respond to this order may result in the issuance of a bench warrant for the employer's arrest.

The AAO has two options after forwarding the report and subpoena to Audit Section. They may:

- Take no action and wait to be notified by the Attorney General, or
- Issue an estimated assessment.

D. SECURING RECORDS - FINANCIAL INSTITUTIONS

1. Introduction

Government Code Sections 7480 and 7490 and CUIIC Section 1092 govern the disclosure of financial records and information by financial institutions to public agencies.

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No employee of EDD may request from a bank, savings and loan association, trust company, credit union, or industrial loan company any information contained in the financial records of any customer unless the request is made pursuant to a written authorization signed by the customer, or pursuant to an administrative *subpoena*, with the exception of:

- Requests to determine if a person has an account(s), and the identifying number(s) of the account(s) that the person may have at the office or branch.
- Requests for disclosure of the amount of any security interest a financial institution may have in a specified asset of a customer.

2. Government Code Section 7465 Definitions

Within the context of this chapter, the following definitions apply.

Financial Institution

A *financial institution* includes state and national banks, state and federal savings and loan associations, trust companies, industrial loan companies, and state and federal credit unions. *Financial institution* does not include a title insurer while engaging in the conduct of the "business of title insurance" as defined by Section 12340.3 of the Insurance Code, an underwritten title company, or as an escrow company.

Financial Records

The term *financial records* means an original or any copy of any record or document held by a financial institution pertaining to a customer of the financial institution.

Customer

A *customer* is defined as any person who has transacted business with, or has used the services of a financial institution or for whom the financial institution has acted as a fiduciary. A financial institution acts as a fiduciary when it is the trustee of a trust, when it is holding an escrow account, and when it is the administrator or executor of an estate.

Person

A *person* means an individual, partnership, corporation, limited liability company, association, trust, or any other legal entity.

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3. Customer Authorization

DE 298C *Customer Authorization* (Government Code Section 7473) is used to obtain customer authorization to review records in the custody of a financial institution. A copy of the signed authorization will be provided to the financial institution for its records.

4. Scheduling the Records Examination

The records examination will be scheduled at a time agreeable to all parties concerned, and will be completed within the 60-day authorization period.

5. Customer Notification

The DE 299C *Customer Notification* (Government Code Section 7473) will be used to notify the customer, within 30 days after the initial examination, that the records have been examined.

6. Explanation of Records Review

The Area Audit Program Manager will prepare a DE 300C *Explanation of Records Review* (Government Code Section 7473) if the employer/customer requests a written explanation of the reason(s) for the records review.

TAX AUDIT GUIDELINES

CHAPTER VI

PRE-AUDIT ACTIVITIES

A. PLANNING

It is important that the auditor take time to anticipate the types of issues or problems which might be encountered during the audit. The auditor will review CUIC sections and reference materials for applicable status issues and procedures prior to conducting the audit.

B. BOOKS AND RECORDS TO BE EXAMINED

Payroll complexity varies among employers. This affects the number and kinds of payroll and related records which are available for audit. The auditor will determine what records the employer maintains and the payroll procedure used. The accounting records maintained by businesses are so varied that it would be impossible to list and describe all of them.

TAX AUDIT GUIDELINES

CHAPTER VII

ENTRANCE INTERVIEW AND ENTITY EXAMINATION

A. INTERVIEW PROCEDURES

- Meet the head of organization or person responsible for the accounting operation.
- Explain the purpose of the visit and the extent of your survey of the payroll and general accounting systems. Give the employer an estimate of the amount of time you will need to conduct the audit, plus provide them with any pertinent forms or documents related to the audit process.
- Ask questions during the interview using the DE 108A as a guideline. Ask any pertinent questions depending on the type of business or entity.
- Request direct access to appropriate individuals in the company, e.g., accountant, payroll supervisor, controller, data processing manager, etc.
- At the conclusion of the entrance interview, inform the employer/representative that you will discuss the results of your examination at the close of the audit (exit interview).

B. ENTITY EXAMINATION/OWNERSHIP VERIFICATION PROCEDURES

The auditor must verify that the entity is a bona fide business operation.

1. Ownership Verification

The auditor will verify that the ownership shown on EDD's records is the same as that found during the course of the audit. For example, if EDD's records indicate a sole proprietor operates the business, the auditor will determine that it actually operated as such, rather than as a partnership, corporation, or other type of entity.

2. EW/UE Verification

If the date that the employer first had payroll (EW date) and/or the date of change in legal entity (unity of enterprise or UE) is within the statutory period, the auditor will verify the dates by reviewing the business records.

3. Business Existence Verification

The business existence should be verified.

Also, whenever possible, the auditor should visit the business location to verify the business' existence.

4. Discussion with the Employer

The auditor must always include entity verification in their discussions with the employer and/or the employer's representative(s).

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TAX AUDIT GUIDELINES

CHAPTER VIII

EXAMINATION OF BOOKS AND RECORDS

A. MANUAL SCHEDULING TECHNIQUES

1. Background

Prior to the development of the Automated Audit Program (AAP), all audit schedules were prepared manually by the auditors. While the majority of audits are completed on the AAP, some assignments may still be completed using manual schedules. Handwritten schedules are generally prepared on two columnar type forms:

- Field Audit Summary (DE 107)
- Audit Worksheets (DE 3637A)

The DE 107 is a summary schedule documenting the wage figures that were developed and used during the audit process. The supporting schedules were generally prepared using one of the six column DE 3637A forms, but could be developed using blank column pads or other paper.

2. Purpose of Field Audit Summary (DE 107)

The DE 107 is required with all manual audits. The DE 107 is a schedule used to summarize the subject wages, excess wages, taxable wages, and PIT reported and audited, during the period covered, as well as the differences found. The DE 107 will reconcile the differences shown on the Schedule of Differences, if used.

The DE 107 is a worksheet from which to prepare a Notice of Assessment-Personal Computer (DE 107PC) and is also designed as an input document for TAS generated Employer Account Statements (DE 2176). The DE 107 provides separate columns for:

- Interquarter adjustments (normally omitted from the DE 107PC or DE 2176).
- Debits (Increase adjustments)
- Credits (Decrease adjustments)

3. Computer Input Data

The blocks at the bottom of the DE 107 are used as a source input document, therefore it will be necessary to identify the CUIIC assessment or credit section, CUIIC penalty section (if applicable), number of wage items, wage item effective dates, assessment number, case number, and TAS liability type.

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4. Abbreviations on DE 107

The following table lists common abbreviations used on the DE 107:

SYMBOL	FUNCTION
NRF	In the "reported" column, the notation "NRF" will be shown for quarters where no returns were filed.
NPR	If a "no payroll" return was filed, the notation "NPR" will be shown in the "reported" column.
SAME	For quarters in which there are no differences between reported and audited figures, the auditor will enter the word "SAME" in the audited wage column.
NV	If the audit/investigation was limited to UI/DI verification only, enter "NV" (not verified) in the Audited and Differences columns for personal Income Tax. You may enter the reported PIT.
CR	Credit entries will be clearly designated by the symbol "CR."

5. Numbering

The manual schedules are required to be titled appropriately and to follow a standard numbering scheme for identification and development of a standard audit trail:

- Schedule I - Audited Wages
- Schedule II - Excess Wages
- Schedule III - Personal Income Tax (PIT)
- Schedule IV - Audit Differences

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These "roman numerals" are then supported by using letters after the numerals such as I-A, I-B, I-C etc. Any supporting schedules for the lettered schedules are then numbered I-A-1, I-A-2, I-A-3 etc. The numbering scheme provides a simple way to recognize the purpose of each schedule as well as to identify whether it is a summary schedule or a supporting schedule for the four categories shown above. This format helps to ensure that subsidiary schedules refer to main schedules.

6. Subsidiary Schedules

Subsidiary schedules support the summary schedules. The accumulation of facts and figures is used to compile the final results which support the audit/investigation findings. The basic data for computing audited figures is recorded on these schedules. In the event of a single source, subsidiary schedules are not necessary.

7. Rules for Documenting Information

- Schedules will contain data relating to the subject matter only. This practice will be followed even if only a few lines are required to record the desired information.
- Each schedule will be set up in the most efficient mechanical arrangement possible. If there is sufficient space on a schedule, lines will be skipped between subsections and totals. This sets the information out and makes it easier to read.
- Adding machine tape will be used and attached to the schedules as a time-saving device. Where possible, avoid hand scheduling.
- Subtotals will be ruled with a single line above and below. Totals will be ruled with a single line above and a double line below. This does not apply to totals appearing on adding machine tapes where printed symbols identify totals and subtotals.
- The number of the form or schedule to which a total is carried forward will be noted by that total.
- Credit items will be clearly designated by "CR".

8. Comments

Sometimes brief comments are necessary in order to explain the contents of a schedule. For example, comments may provide:

- Source of data.
- Extent of verification.
- Basis for estimate when estimates are involved.

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- Method of calculating percentages.
- Reasoning or method used to determine the facts and figures shown on the schedule.
- Resolution of questionable items.

Use symbols, numbers, or letters when footnoting.

B. VERIFICATION OF ACKNOWLEDGED PAYROLL

1. Introduction

The auditor will reconcile the acknowledged payroll reported to the Department for a minimum of four representative quarters, with the employer's accounting records to identify any discrepancies. Acknowledged payroll is the total of all payments made by, or on behalf of the employer, that the employer reported as wages.

2. Selection of Representative Quarters

- Careful consideration will be given to determining which quarters will be covered by the audit.

C. VERIFICATION OF TAXABLE WAGES

1. Purpose

The auditor must determine whether or not the employer properly applied the taxable wage limitation provisions of CUIIC sections 930(UI) and 985(DI). If they are not properly applied, either an overpayment or underpayment will result.

2. Computation of Wages to the Taxable Limits

The auditor will reconcile reported wages to the taxable wage limits using the employer's accounting records for a minimum of four representative quarters. Taxable wages should be verified on a calendar year basis. For example, if the four quarters selected for audit are the period 93-3 through 94-2, the taxable wage test should cover the period from 93-1 through 93-4.

3. CUIIC Sections 930.1 and 930.5

CUIIC section 930.1 provides that a California employer who pays wages to an employee for employment subject to the unemployment insurance laws of another state (and reports to that state), can use such wages in computing the UI taxable wage limit if the individual is subsequently transferred to California. Such wages cannot be used to arrive at the taxable wage limit for disability insurance purposes.

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In reconciling wages to the taxable limits, consideration must also be given to CUI Section 930.5 (predecessor-successor, for both UI and DI purposes).

Out of state wages may be counted toward the unemployment limitations (but not DI) if the transferred employee formerly worked in a business acquired by the California employer as set forth in CUI Section 930.5.

D. PIT VERIFICATION TESTS

1. Verify Total Pit Withheld for One Quarter

This test is performed on all regular 312 audits and large 342 audits. The PIT withholding test is performed to ensure that all personal income tax withheld from acknowledged employees is properly reported to EDD. If PIT was not properly withheld or reported, the PIT Adjustments Screen is used to include the PIT adjustment in the Audit Summary Report and in the Consolidated Audit Summary Report.

2. Withholding Computation

The PIT withholding test is performed to ensure that the employer is properly calculating and withholding personal income tax from subject wages.

3. Verification of W-4/DE 4 Compliance

Title 22, California Code of Regulations, Section 4340-1, sets forth the requirements for employers to submit W-4/DE 4s for verification of withholding status. The regulation relieves employers from submitting W-4s/DE 4s to EDD in most cases and incorporates federal requirements for submitting the remainder.

Employers are required to send a copy of withholding allowance certificates (W-4 or DE 4) or the information contained on the form to EDD with the quarterly tax return if:

- The employer did not send similar information to the Internal Revenue Service (IRS), and
- The State and Federal withholding status claimed by an employee differ, and
- The State withholding status claimed meets federal requirements for submitting a W-4 and the federal withholding status claimed does not meet the requirements. Pursuant to IRC Reg. Sec. 31.3402(f)(2) - 1(g), a W-4 is required to be submitted for federal purposes, if:
 - The employee claims in excess of ten (10) withholding exemptions.
 - The employee claims to be exempt from withholding and weekly wages usually exceed \$200 per week.

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- An employee makes material alterations on the certificate such as: deleting language, defacing the form, or providing information other than that requested.
- An employee files a certificate which the employee admits is false.

If the test reveals the employer did not comply with the submission requirements, the auditor will determine if the employer was aware of the submission requirements. If the employer is unaware of the requirements, he/she will be furnished with the handout Employer's Responsibilities for DE 4 or W-4 (DE 71).

Title 22, California Code of Regulations, Section 4340-1, requires employers to submit copies of DE 4s to EDD when the exemption certifications claim more than 10 withholding allowances.

The auditor will inquire if the employer received a determination letter from the IRS or FTB disallowing a W-4. If a determination letter was issued, the auditor will review the records to determine if the employer complied with the instructions to withhold on the basis of single - zero, or if the employer submitted a new acceptable W-4 or DE 4 to the employer. If the employer has not complied, the auditor will assess the employer for the difference between the amount actually withheld and the amount required to be withheld.

E. LARGE EMPLOYER

1. Definition of a Large Employer

The United States Department Of Labor defines a large employer as an employing unit subject to UI (including UI-DI, UI-DI-PIT employers) where California wages have been paid to 100 or more individuals or California UI taxable wages paid of at least \$1,000,000 in any calendar year within the audit period.

2. Arranging the Audit Appointment

The auditor will make proper arrangements before commencing an audit to insure that he/she will be able to review records and complete the audit.

3. Pre-Audit Conference

During the initial meeting with the controller or others, the auditor will determine if accounting records and management tools are available for use during the audit.

4. Federal Requirements Regarding EDP Records

- Legal Requirement for Maintaining EDP Records

IRS Revenue Ruling 71-20 (1971-1 C.B. 392) provides that punched cards, magnetic tapes, disks, and other machine-sensible data media used in the automatic data processing of account transactions constitute records within the meaning of IRC Section 6001 and IRC Reg. Sec. 1.6001-1.

- IRC Section 6001

IRC Section 6001 provides that every person liable for any tax imposed by the IRC, or for the collection thereof, shall keep such records as the Secretary of the Treasury or his/her delegate may from time to time prescribe.

- IRC Reg. Sec. 1.6001-(e)

IRC Reg. Sec. 1.6001-1(e) provides that the books and records required by this section shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

- IRS Revenue Procedure 98-25

IRS Revenue Procedure 98-25 (1998-1c.b.689) sets forth the record requirements to be followed by taxpayers who maintain all or part of their accounting records on ADP equipment.

Adequate record retention facilities must be available for storing tapes and printouts, as well as applicable supporting documents. These records must be retained in accordance with the provisions of the IRC and the regulations prescribed thereunder.

TAX AUDIT GUIDELINES

CHAPTER IX

FACT GATHERING AND STATUS DETERMINATIONS

A. GUIDELINES FOR MAKING STATUS DETERMINATIONS

1. Procedures

Auditors will use the following guidelines when making status determinations:

- **Explain Process:**
When discussing questionable items with employers, the auditor should start by explaining the process he/she will go through to determine whether the workers are independent contractors or employees. Even though the auditor may have discussed the status determination process during the entrance interview, they should reiterate it when discussing status issues, if necessary, to help the employer understand the process.
- **Gather Information:**
When securing information from the employer, the auditor will gather documentation and ask questions regarding the working relationship. They will ask the employer why he/she believes the workers in question are independent contractors. This may bring out issues that the auditor has not considered.
- **Allow the Employer Sufficient Time:**
The auditor must allow the employer a reasonable amount of time to provide pertinent information regarding the working relationship. The auditor should accept the evidence without making any conclusions or debating whether specific conditions create an independent contractor relationship.
- **Conduct Exit Interview:**
The auditor must offer an exit interview to the appropriate owner or officer of the employing unit, rather than to a bookkeeper or accountant. The auditor will discuss the status determination with the employer, highlighting the key factors of the relationship which affected the determination. The auditor will discuss factors in the relationship indicating independence, as well as those indicating employment. If the weight of factors indicate that an employment relationship exists, the auditor will explain why the factors indicating independence are outweighed by other employment factors.
- **Use Additional Resources to Explain Determination:**
Whenever possible, discuss with the employer CUIAB Precedent Tax decisions, CUIAB decisions, and/or court decisions which address similar status issues to support your determination. Give copies of the decisions to the employer.

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- Offer Preassessment Conference:
A preassessment conference conducted by the auditors supervisor should be offered to employers, in all instances.

Although auditors may need to deviate from this method in certain situations, every attempt must be made to follow these procedures when making a status determination.

B. APPLICATION OF COMMON LAW RULES

1. Introduction

The most common type of status determination that an auditor will be required to make involves the application of common law. Common law has its basis in the old English common law principals of master/servant. These original relationships have continued to evolve in our modern society and are continually expanded and redefined through administrative and judicial interpretations. Through a systematic application of the common law principals, the auditor determines if the working relationship between the employer and worker is that of common law employment or if, in fact, the work being performed is that of an independent contractor.

2. Legal References

The following four court cases form the basis of the common law interpretations for the Department:

- Empire Star Mines v. California Employment Commission (1946) 28 Cal.2d. 33, 168. P.2d 686.
- Isenberg v. California Employment Stabilization Commission (1947) 30 Cal.2d 34, 180 p.2d 11.
- Tieberg v. California Unemployment Insurance Appeals Board (1970) 2 Cal.3d 943, 471 P. 2d 975.
- S. G. Borello & Sons v. Department of Industrial Relations (1989) 48 Cal.3d. 341, 769 P. 2d 399.

3. Case Analysis

The following steps should be followed, as necessary, when analyzing a case and making a common law status determination:

- Document why the principal considered the workers to be independent contractors.

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- All of the important facts will be gathered.
- The legal issues and researched court cases will be identified and reviewed.
- Primary and secondary factors of direction and control will be identified and reviewed.
- The law will be applied to the facts in each case.

4. Direction and Control

The auditor's goal in making a status determination is to gather sufficient facts so that the entire working relationship can be understood and a proper determination made. The working relationship is analyzed to determine if the employer can exercise direction and control over the services performed by the worker. While the principal may not exercise the direction and control, the key factor is whether the right of control exists. Strong evidence of control is the principal's right to discharge at will, without cause. The primary right of direction and control is discussed in Title 22, California Code of Regulations, Section 4304-1.

If the auditor cannot determine if the right of direction and control exists, the auditor must evaluate the working relationship in terms of the secondary factors discussed in Title 22, California Code of Regulations, Section 4304-1.

5. Secondary Factors

The secondary employment factors must be considered when direction and control are not clearly present. The auditor must look at the factors in their entirety and not at one single factor. The factors that show control over the manner and means of the work are to be weighed against those that point to independent contractor status.

Under common law, all factors do not have equal weight but must be considered together.

If, by a consideration of all the facts, the principal retains the right of control, an employment relationship exists. If the factors show that the worker is generally free from the employer's control over the manner and means by which the services are performed, and is a self-employed person contracting for an end result, an independent contractor relationship exists. Elements of control that exist because of regulatory or legal requirements are not considered factors of control by an employer.

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The following comparison chart of 'Employment' and 'Independent Contractor' factors will assist the auditor in making this determination:

ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
1. Instructions	A worker who is required to comply with instructions about when, where, and how to work is ordinarily an employee. The instructions may be in the form of manuals or written procedures that show how the desired result is to be accomplished. Some employees may work without receiving instructions because they are highly proficient and conscientious workers. Even if no instructions are given, the control factor is present if the employer has the <u>right</u> to give instructions.	An independent contractor decides how to do the job, establishes his or her own procedures, and is not supervised. The entity engaging his or her services is only interested in the end result.
2. Training	Training of a worker by an experienced employee working with him or her, by correspondence; by	An independent contractor ordinarily uses his or her own methods and receives no training

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
2. Training (cont.)	required attendance at meetings or by other methods, is a factor of control indicating that the employer wants the services performed in a particular manner. This is especially true if the training is given periodically or at frequent intervals.	from the purchaser of the services. He or she is not required to attend meetings.
3. Integration	If the individual's services are so integrated into an employer's operations that the success or continuation of the business depends on the performance of the services, it generally indicates employment.	If the individual's performance of service and those of his/her assistants establish, or affect his or her own business reputation and not the business reputation of those who purchase his services, it is an indication of an independent contractor relationship.
4. Services Rendered Personally	If the services must be rendered personally, it indicates the employer is interested in the methods, as well as the results.	An individual's right to substitute another's services without the employer's knowledge suggests the existence of an independent relationship.
5. Hiring Assistants	An employee works for an employer who hires, supervises, and pays	An independent contractor hires, supervises, and pays

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
5. Hiring Assistants (cont.)	assistants. If an employee hires and supervises assistants at the direction of the employer, he or she is acting as an employee in the capacity of a foreman or representative of the employer.	assistants under a contract that requires him or her to provide materials and labor.
6. Continuing Relationship	The existence of a continuing relationship between an individual and the person for whom he or she performs services indicates an employer-employee relationship. If the arrangement consists of continuing or recurring work, the relationship is considered permanent, even if the services are rendered on a part-time basis, are seasonal in nature, or if the person actually works for only a short time.	The relationship between an independent contractor and his or her client ends when the job is finished.
7. Set Hours of Work	The establishment of set hours of work by the employer is a factor of control. If the nature of the occupation makes fixed hours impractical, a requirement that the worker work at certain times is an element of control.	An independent contractor is the master of his or her own time.

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
8. Full-Time Work	Full-time work for the business is indicative of control by the employer since it restricts the worker from doing other gainful work. Full-time does not necessarily mean an eight hour day or a five day week. Its meaning may vary with the intent of the parties, the nature of the occupation, and the customs in the locality. These conditions should be considered in defining full-time. Full-time services may be required even though not specified orally or in writing.	An independent contractor is free to work when he or she chooses and to set his or her daily or weekly schedule. An independent contractor would normally perform services less than full-time for one principal.
9. Work Done on Premises	Doing the work on the employer's premises, or on a route, or at a location designated by an employer implies employer control, especially where the work is of such a nature that it could be done elsewhere. The use of desk space and of telephone and stenographic services provided by an employer places the worker within the employer's direction	Doing work away from the employer's premises when it could be done on the employer's premises indicates a lack of control, especially when the work is free from supervision.

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
9. Work Done on Premises (cont.)	and supervision unless the worker has the option as to whether he or she wants to use these facilities. However, the fact that work is done off the premises does not indicate freedom from control since some occupations, e.g., employees of construction contractors, are necessarily performed away from the employers premises.	
10. Order or Sequence Set	If a person must perform services in the order or sequence set by the employer, it shows that the worker is not free to follow an independent pattern of work, but must follow the established routines and schedules of the employer. Often, because of the nature of the occupation, the employer either does not set the order of the services or sets them infrequently. Control is sufficiently shown, however, if the employer retains the right to do so.	If the person engaging the services is not interested in the order or sequence by which the individual completes the work, there is an indication that there is a lack of control over the manner and means by which the work is performed.

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
11. Reports	The submission of regular oral or written reports indicates control since the worker must account for his or her actions.	An independent contractor is not required to file reports which constitutes a review of his work. (However, reports related only to an end result are not an indication of employment or independence.)
12. Payments	<p>Payment by the hour, week, or month, represents an employer-employee relationship.</p> <p>The guarantee of a minimum salary or the granting of a drawing account at stated intervals with no requirement for repayment of the excess over earnings, tends to indicate the existence of an employer-employee relationship.</p>	Payment on a commission or job basis is customary where the worker is an independent contractor. Payment by the job includes a lump sum computed by the number of hours required to do the job at a fixed rate per hour.
13. Expenses	Payment of the worker's business and travel expenses by the employer indicates control over the worker.	A person who is paid on a job basis and who has to take care of all incidental expenses is generally an independent contractor. Since the person is accountable to no other person for the expenses, the

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
13. Expenses (cont.)		the person is free to work according to his or her own methods and means
14. Tools and Materials	The furnishing of tools, materials, etc., by the employer indicates control over the worker. In some occupations and industries it is customary for individuals to provide their own tools, which are usually small hand tools; in that case, workers may also be considered to be employees.	When a worker furnishes tools and materials, especially when a substantial sum is involved there is an indication of independence.
15. Investment	The furnishing of all necessary facilities by the employer tends to indicate an employment relationship. Facilities include generally, equipment or premises necessary for the work but not tools, instruments, clothing, etc., which are commonly provided by employees in their particular trade.	A significant investment by the worker in facilities used by him in performing services for another tends to show an independent status.
16. Profit and Loss	When workers are insulated from loss or are restricted in the amount of profit they can gain, they usually are employees. The opportunity for higher earnings, such as from	The possibility of a profit or loss for the worker as a result of his/her services generally shows independent contractor status. Profit or loss implies

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
16. Profit and Loss (cont.)	pay on a piece work basis or the possibility of gain or loss from a commission arrangement, is not considered profit or loss.	the use of capital by the individual in an independent business. Profit or loss generally depends on his/her own decisions. Factors include: whether he/she hires, directs, and pays assistants; has his/her own office, equipment, materials or other facilities for doing the work; has continuing/recurring liabilities/obligations and pays his/her own expenses.
17. Workers for More Than One Person or Firm	It is possible that a person may work for a number of people or firms and still be an employee of one or all of them because he/she works under the control of each firm.	Work for a number of persons or firms at the same time usually indicates an independent contractor status because the worker is usually free, in such cases, to accept or reject assignments.
18. Offers Services to General Public	If a worker performs service for only one person, does not advertise his or her services to the general public, does not hold licenses, or hire assistants, and performs services on a continuing	The availability of services to the general public usually indicates independent contractor status. This may be evidenced by the worker having his or her own office and

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
18. Offers Services to General Public (cont.)	basis, it is an indication of employment relationship.	assistants, hanging out a “shingle” in front of his or her home or office, holding business licenses, maintaining business listings in telephone directories, or advertising in newspapers, trade journals, magazines, etc.
19. Right to Fire	If an employer has the right to discharge an individual at will without liability, that worker is considered an employee. The employer exercises the control through the ever-present threat of dismissal, which causes the worker to obey instructions. A restriction on the employer’s right to discharge in a labor union contract does not detract from the existence of an employment relationship.	An independent contractor cannot be discharged as long as he produces a result that measures up to his contract specifications. However, the relationship can be terminated with liability.
20. Right to Quit	The <u>right to quit</u> at any time without incurring liability indicates an employer-employee relationship.	An independent contractor usually agrees to complete a specific job and he or she is responsible for its satisfactory completion or is legally obligated to make good faith to complete the job. If

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ELEMENTS	EMPLOYMENT	INDEPENDENT CONTRACTORS
20. Right to Quit (cont.)		the principal terminates an independent contractor on a contract job without cause, the principal is still liable to the independent contractor for the job.
21. Custom in Industry and Location	If the work is traditionally performed by employees under the direction of a supervisor, it is an indication of employment.	If the work is usually performed by independent contractors, it is an indication of independence.
22. Required Level of Skill	A low level of technical skill is strong evidence of employment, since as the skill level declines there is less room to exercise the discretion necessary for independence.	A high level of technical skill is important when combined with other factors such as owning a separate and distinct business.
23. Belief of Parties	<p>It is an indication of employment if:</p> <ul style="list-style-type: none"> • Both the worker and the State believe the relationship is employment. • If either party believe that the relationship is employment. 	If all parties agree that the relationship is one of independence, it may be. However, consideration should be given to the fact that many individuals do not know how an employee determination is made, and believe they are an independent contractor because they were told they are.

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6. Common Law Rules for Specific Industries

Title 22, California Code of Regulations, Sections 4304.2 through 4304-12, sets forth specific application of the common law rules for specific industries. These regulations must be addressed when making employee vs. independent contractor status determinations involving a type of worker or service. The following types of services are addressed:

- Real Estate Salespeople (Title 22, CCR, Section 4304.2)
- Home Health Care (Title 22, CCR, Section 4304.3)
- Computer Services (Title 22, CCR, Section 4304-4)
- Artists (Title 22, CCR, Section 4304-5)
- Newspaper Distribution (Title 22, CCR, Section 4304-6)
- Product Demonstrators (Title 22, CCR, Section 4304-7)
- Security Dealers (Title 22, CCR, Section 4304-8)
- Language Interpreters (Title 22, CCR, Section 4304-9)
- Amateur Athletic Officials (Title 22, CCR, Section 4304-10)
- Process Servers (Title 22, CCR, Section 4304-11)
- Barbering and Cosmetology (Title 22, CCR, Section 4304-12)

C. APPLICATION OF STATUTORY EMPLOYMENT RULES

1. Introduction

Certain classifications of services have been included in the CUIIC as statutory employment. These select classes of workers are generally covered by the CUIIC for purposes of UI, DI, and ETT only. Personal income tax withholding is not required if a statutory worker does not also meet the common law tests for employment, except for statutory employees in the construction industry and corporate officers.

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2. Statutory Employees

Statutory employment is identified in the CUIC. Auditors must be familiar with these specific employer groups and apply the appropriate code sections in determining if the work being performed fits any of the statutory provisions of the CUIC. Specific classes of workers include:

	UI - DI - ETT:	PIT:
Corporate Officers	Sec. 621(a)	Sec. 13004
Agent or commission driver	Sec. 621(c)(1)(A)	
Traveling or city salesman	Sec. 621(c)(1)(B)	
Homeworkers	Sec. 621(c)(1)(C)	
Unlicensed workers	Sec. 621.5(a)&(b)	Sec. 13004.5(a)& (b)
Artists and authors	Sec. 601.5	

D. TEMPORARY SERVICES AND EMPLOYEE LEASING INDUSTRY, CUIC SECTION 606.5

1. Introduction

Determining the correct employer in the temporary services and employee leasing industries involves the application of CUIC Section 606.5. Section 606.5 defines the employer in a situation where an individual or entity contracts with a client or customer to supply workers (employees) to perform services for the client or customer.

2. Steps for Determining the Correct Employer Under CUIC Section 606.5

- A. The auditor must first determine if the workers are employees under common law (CUIC Section 621(b)). If workers are not employees, then CUIC Section 606.5 does not apply.

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- B. The auditor must determine if the individual or entity contracts to supply employees to perform services for the client or customer. If not, CUIC Section 606.5 does not apply.
- Is there a three cornered relationship commonly known as a general/special employer situation? The individual or entity must supply employees and the client would have certain rights to direct and control employees in order for CUIC Section 606.5 to apply.
 - If the client does NOT have the right to supervise the employee, then a three cornered relationship does not exist. In such cases, a service is being provided and not an employee. Example; plumbing, electrical and income tax work, where the client is paying for a service and the client does not supervise the employee.
- C. The auditor must determine if all seven points of CUIC Section 606.5 (b) apply.
- D. The auditor must determine the identity of the employer based on CUIC Section 606.5 (c).

If the individual or entity contracts to supply employees and meets all seven points, then the individual or entity is the employer.

If the individual or entity contracts to supply employees but does not meet all seven points, then the client or customer is the employer.

3. Key Facts for Determination

The following is a partial listing of the types of information needed with respect to the three party relationship that the auditor must obtain in order to correctly determine if CUIC section 606.5 is applicable:

- A. Obtain a copy of the written agreement between the leasing employer and the client, if available.
- B. Facts surrounding the three party relationship, to include:
- Whether the terms are consistent for different clients?
 - If the client has the right to supervise the worker?
 - Whether the services are in employment?
 - Where the work is performed?

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- Who establishes the workers' duties?
- Who establishes the working conditions?
- Who establishes the work hours?
- Who sets the standards for work quality?
- Who determines the price for the service?
- Who determines the worker's rate of pay?
- From whose account the workers are paid?
- Who determines which worker is assigned to a client?
- How are workers reassigned?
- If the worker can refuse a specific assignment?
- Who hires and terminates workers?
- If the worker is unacceptable:
 - Who reassigns the worker?
 - Who terminates the worker?
- Does the leasing employer or referral service supply the worker?
- What was the length of the relationship between the parties?
- Is the worker a former employee of the client?

TAX AUDIT GUIDELINES

CHAPTER X

PERSONAL INCOME TAX ASSESSMENT AND ABATEMENT

A. OVERVIEW

1. Introduction

CUIC Section 13071 provides that if an employer fails to withhold Personal Income Tax (PIT) from an employee's wages and the wages have been reported on the employee's State personal income tax return, the tax will not be collected from the employer. This section further provides that the employer will not be relieved of any penalties or additions otherwise applicable for failure to deduct and withhold. While it is the employer's responsibility to seek relief from paying the PIT assessed, auditors must explain the process to the employer and give the employer a copy of the PIT Abatement Fact Sheet, DE 231W.

2. PIT Liability Assessed

When the employer has failed to properly withhold PIT, the liability, including applicable penalty and interest, is assessed.

It is possible that the PIT liability assessed can include PIT withheld but not reported, as well as PIT that was not withheld. Both types of PIT liability can be included in the same assessment. However, only the PIT that was not withheld can be abated.

3. Two Separate Types of Relief

CUIC Section 13071 provides an abatement of the PIT assessed, but provides no relief from the penalties and interest attributable to the assessed tax liability.

CUIC Section 1136 allows for an adjustment of PIT assessed, as well as the penalties and interest associated with the tax. An employer who has had PIT assessed at a percentage rate (e.g. 6%) may recompute the PIT liability to reduce the amount of PIT assessed.

4. Claim for Adjustment or Refund of Personal Income Tax DE 938P

In order to grant relief to the employer for the PIT assessed, EDD uses the *Claim for Adjustment or Refund of Personal Income Tax DE 938P*. This form provides three methods available to the employer to gain either full or partial relief of the assessed liability:

- Employee certification or Franchise Tax Board (FTB) certification that the income tax liability has been paid by filing a personal income tax return (abatement).

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- Recomputation of the assessed tax liability using W4/DE4 forms for the individual workers, or by using S-0 when no W4/DE4 is available.
- Adjustment of the liability based on quarterly estimated tax payments that have been made by the individual workers.

4. Bankruptcy

DE 938Ps will be provided to the employer in the usual manner. The procedures contained in this chapter also apply to the bankrupt employer.

5. Obtaining DE 938Ps for Verification

As part of the audit process, the auditor will provide the employer with the DE 938Ps needed to abate the PIT assessed.

TAX AUDIT GUIDELINES

CHAPTER XI

PENALTY DETERMINATION/APPLICATION

A. PENALTIES - OVERVIEW

EDD is responsible for promoting voluntary compliance. Part of this responsibility includes educating the employer. When the employer fails to voluntarily file and/or pay the appropriate taxes, it affects not only the State's revenue but the potential benefits of employees. The employer must understand that failure to comply will generate a penalty.

B. PENALTY DETERMINATION – CUIC SECTION 803

1. Description

CUIC Section 803 allows nonprofit and governmental employers to elect the "Cost of Benefits" method of financing unemployment insurance.

An employer is required to pay the cost of benefits as stated on the Notice of Determination within 30 days of the date of mailing, unless there is evidence of good cause. Any entity which, without good cause, fails to pay contributions timely shall pay a penalty of ten percent of the contributions. The Director may, for good cause, extend the time for paying contributions without penalty for a period not to exceed 60 days.

An employer who is notified of contributions due and fails to pay those contributions within the time required, pursuant to CUIC Section 803 will be assessed those contributions under CUIC Section 1127. Interest will be charged on the contributions from the delinquency date, (which is the 30 days from the date of mailing of the Notice of Determination) until paid.

For Example:

A water district received a "Notice of Determination" for cost of benefits on October 15. However, the district does not pay this request for payment until November 30, and does not show evidence of good cause for an extension to pay. Under CUIC Section 803, EDD will assess the water district for cost of benefits and charge a penalty of ten (10) percent of the contributions, plus interest.

C. PENALTY DETERMINATION – CUIC SECTIONS 1112(a) and 1112(b)

CUIC Section 1112(a) provides: "Any employer who without good cause fails to pay any contributions required of him or her or of his or her workers, except amounts assessed under Article 8 of this chapter, within the time required shall pay a penalty of ten percent of the amount of those contributions."

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CUIC Section 1112(b), provides that: “Any employer required to remit payments by electronic funds transfer pursuant to Section 13021, who without good cause remits those amounts by means other than electronic funds transfer shall pay a penalty of 10 percent of the amount of those contributions.

1. Upon Closing Business

CUIC Section 1116 provides, in part, that every employing unit will, within 10 days of quitting business or within 10 days of commencement of proceedings to wind up the business affairs of a corporation, file a final return and report of wages with EDD.

A penalty will be charged under CUIC Section 1112(a) when contributions due on a CUIC Section 1116 final return are paid after the:

- Tenth day, or
- Extension period granted for good cause (up to 30 days)

Where a final return, partially paid, fully paid, or unpaid, is filed after the delinquent date for the quarter, penalty under CUIC Section 1112 will be charged.

2. Consolidated Return

EDD will consider a consolidated return, a return covering more than one quarter, to be a return for each quarter, but will charge penalty under CUIC Section 1112(a) for any quarter in which the contributions were not paid timely, unless good cause is found.

For Example:

A Quarterly Wage and Withholding Report (DE 6) is filed and paid in January and is identified for the fourth quarter of the prior year. The DE 6 also contains wage information for the third quarter of the prior year. The DE 6 will be considered timely for the current quarter only. Once the wages and contributions applicable to the third quarter are properly applied to that quarter, CUIC Section 1112(a) penalty will accrue on the normal delinquency date of the third quarter.

3. Supplemental Returns

If amended or supplemental returns are received, TAS will bill the employer for additional contributions due and charge any applicable CUIC Section 1112 penalties.

When contributions on the supplemental return are partially paid, or contributions are unpaid but the return is signed, TAS will bill the employer under CUIC Section 1110 for unpaid contributions, and charge ten (10) percent penalty and interest under CUIC Sections 1112 and 1113 on the delinquent contributions. Penalty will not be waived or canceled if there exists a prior quarter return delinquency or other unpaid liability or both.

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4. Hybrid Assessment

If a “hybrid” assessment (an assessment levied for contributions known to be due but which are not yet delinquent) is levied under CUIC Section 1127 for a quarter which is due but not yet delinquent, penalty is not charged. Penalty under CUIC Section 1112 will begin to accrue on the normal delinquency date of the quarter. The penalty provisions of CUIC Sections 1126, 1127, 1128, and 1135 will not apply.

CUIC Section 1112 penalty on delinquent reports processed through TAS will be calculated automatically. When there is a hybrid assessment or an assessment for a final return due under CUIC Section 1116, a manual adjustment may be necessary to remove a penalty automatically charged under CUIC Section 1112.

D. PENALTY DETERMINATION – CUIC SECTION 1112.5

1. Overview

The CUIC Section 1112.5 ten (10) percent penalty shall be added to the amount of contributions due when an employer has not filed a required return within sixty (60) days of the delinquency date for the quarter. This will be in addition to penalties under CUIC Sections 1112, 1114, 1126, 1127, and 1128.

The sixty (60) days will be computed by counting the first day after the final timely filing date and ending 60 days thereafter. When the 60th day falls on a Saturday, Sunday, or holiday, the next succeeding business day becomes the 60th day.

The delinquency date of the return shall be determined without regard to any extension of time for filing which was granted under CUIC Section 1111. Employers should be informed that when extensions are granted, this penalty will apply if the returns are filed more than sixty (60) days after the original delinquency date of the quarter.

Since the CUIC Section 1112.5 penalty is a penalty under Article 7, CUIC, there are no appeal rights unless the penalty is paid and a claim for refund is made and denied. However, this penalty is calculated on contributions and personal income tax owed, and in cases where there is an assessment issued which is appealed, the penalty would be reduced proportionally for any part of the assessment which is reduced.

2. When Penalty Applies

The CUI Section 1112.5 penalty will apply when:

- The return or the return and the report of wages are filed more than sixty days after the final filing date of the quarter.
- An assessment is issued where no return has been filed and it is more than sixty days delinquent.
- An assessment is issued where the return was filed, but it was more than sixty days delinquent when it was filed.
- In cases where an audit or investigation reveals a previously non-registered employer for quarters that are more than sixty days delinquent.

3. When Penalty Does Not Apply

The CUI Section 1112.5 penalty shall not apply when:

- It is determined that the employer had “good cause” for not registering or reporting.
- To any contributions which were paid before the delinquency date of the quarter.
- To DE 938s or supplemental returns which are voluntarily filed, unless the original return that they adjust was filed for the quarter and was more than sixty days late.
- In cases where an assessment is issued prior to the date on which the penalty would apply; e.g., an assessment issued on the basis of an unpaid, unsigned return, or an assessment issued from an audit before the sixty days have elapsed.
- When “no payroll” returns were filed, unless the returns were filed more than sixty days late, the returns are found to be deficient, and there is no “good cause”.
- To DE 88 payments paid prior to the delinquency date of the quarter, even though they were not paid by the deposit due dates.
- This penalty shall apply to disability insurance contributions and personal income tax owed by unemployment insurance reimbursable employers, but not to the cost of unemployment insurance benefits paid.

4. Cancellation of CUI Section 1112.5 Penalty

TAS will charge the CUI Section 1112.5 penalty automatically based on the return postmark (effective) date. If good cause has been found for the failure to file, the penalty will be canceled.

If the employer files a petition for reassessment, and good cause has not been found, the CUI Section 1112.5 penalty is canceled until a decision denying the petition is issued. The penalties will be reestablished when the CUI section 1112.5 penalty is processed.

Facts supporting the determination that good cause does or does not apply must be included in any audit or investigation file.

E. PENALTY DETERMINATION – CUIC SECTION 1114

When an employer fails to file a report of wages within 15 days after EDD has made a specific written demand, a Wage Item Penalty (WIP) will be charged, unless it has been determined that “good cause” exists.

This penalty is charged in addition to other penalties charged under CUIC Sections and is computed at the rate of \$10.00 for each unreported wage item.

1. Number of Wage Items

The number of wage items may be estimated on the basis of:

- Prior quarterly returns,
- Information on the registration form, or
- Any other information available.

2. Specific Written Demand

A specific written demand is one of the following:

- DE 2176, Employer Statement of Account containing a written demand,
- DE 1333, Demand for Wage Information, or
- A letter which contains a specific written demand for Quarterly Wage Information. The demand may be issued by the AAPM.

3. Good Cause

The auditor will determine whether “good cause” for waiver of the Wage Item Penalty (WIP) penalty exists. The good cause determination will be made for each quarter in which the report of wages was not filed. Good cause may exist in one quarter, but not in another.

4. Establishment of 15-day periods

STEP	PROCEDURE
1	Calculate the basic 15 days allowed by CUIC Section 1114(a). The first day is the day following personal service of the demand or the day following deposit of the demand in the United States mail.
2	If the 15th day falls on a Saturday, Sunday, or holiday, extend it to include the next business day, per Government Code Section 6707.
3	<p>If the demand is issued by mail, Code of Civil Procedure Section 1013 extends the last timely date as follows:</p> <ul style="list-style-type: none"> • Five days if the place of business is in California. • Ten days if the place of business is outside of California but within the United States. • Twenty days if the place of business is outside the United States.
4	If Step 3 ends on a Saturday, Sunday, or holiday, extend to include the next business day per Government Code Section 6707.

5. Month Defined

Title 22, CCR, Section 125-(c) defines "month" as:

"Month means the time beginning with any day of one month to the corresponding day of the next month, or if there is no corresponding day, then through the last day of the next month."

Example:

On Friday, February 26, EDD mailed a specific written demand to an employer located in San Francisco. The employer had failed to file a report of wages for two (2) wage items. To determine the last timely date for the employer to file the wage report, add fifteen (15) days to the mailing date of February 26. The 15th day falls on a Saturday, March 13. Thus, the date is extended to Monday, March 15. It is also extended another 5 days under section 1013, CCP, which is Saturday, March 20. Therefore, the last timely date for the employer to file the wage report is Monday, March 22.

March 23 is the first day that penalty would apply.

If the report of wages was filed on or after Tuesday, March 23, the penalty charge would be WIP of \$20.00 (two wage items x \$10.00 = \$20.00).

NOTE: The auditor will determine whether good cause exists for waiver of penalty.

F. OTHER PENALTY APPLICATIONS - CUIC SECTION 1114

1. No Payroll Report Filed

A "no payroll" return filed in answer to a demand for a delinquent quarter is sufficient to clear the return delinquency. However, if subsequent receipt of a report, or discovery by EDD of earnings for the same quarter, then WIP would be charged unless good cause is found. WIP would be charged at the rate applicable at the time the subsequent return was filed or additional wages were discovered.

2. Estimated Assessment

If a report of wages is filed and is determined to be correct, or the Department discovers the correct number of wage items subsequent to the issuing of an estimated assessment, the amount of WIP charged will be adjusted (either upward or downward) to match the WIP calculated as due on the date that the correct number of wage items were filed or discovered.

3. WIP for Dual Employer

When an employer has more than one account number, a "report of wages" filed under one account does not constitute a "report of wages" filed for the other account; nor does a demand under CUIC section 1114 issued on one account constitute a demand for the other account.

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4. WIP Prior to Base Period

WIP is not charged for quarters which are prior to the base period of potential claims for benefits at the time the demand was issued.

5. Wages Legally Due but Unpaid

Penalty under CUIIC Section 1114(a) will be charged if an employer does not file within 15 days after a specific written demand, a special wage report for "wages legally due but unpaid." This report is required by the Title 22, California Code of Regulations, Section 1088-3, and penalty will be charged unless the employer provides evidence of good cause for failure to file the special wage report.

If it is determined that a consolidated wage-earner report has been filed covering both wages actually or constructively paid (Title 22, California Code of Regulations, Section 926-1) and "wages legally due but unpaid" (Title 22, California Code of Regulations, Section 1088-3), then a specific written demand will be issued requesting that the employer file split wage reports within 15 days. If the employer fails to comply within the 15 days specified, then penalty under CUIIC Section 1114 (a) will be charged unless good cause is found. In such case, CUIIC Section 1114 (a) penalty will be charged only on that portion of the report required by Title 22, California Code of Regulations, Section 1088-3

6. Self- Coverage

WIP does not apply to elective self-coverage provisions under CUIIC Section 708 or 708.5.

G. PENALTY DETERMINATION - CUIIC SECTION 1117

CUIIC Section 1117 provides that if any employer who fails, without good cause, to file the annual reconciliation statement (Form DE 7) within 30 days after being notified of his or her failure to file, the employer will be charged a penalty of one thousand dollars (\$1,000) or 5 percent of the total contributions for UI, ETT, DI, and PIT, whichever is less.

H. PENALTY DETERMINATION - CUIIC SECTIONS 1126, 1126.1, and 1127

1. CUIIC Section 1126 Description

When an employing unit fails to file a return, a penalty of ten (10) percent of the contributions payable is mandatory under CUIIC Section 1126. The CUIIC contains no provisions for waiver of this penalty.

2. CUIC Section 1126.1 Description

CUIC Section 1126.1 authorizes a penalty of one hundred dollars (\$100) per non-reported employee when an employer has failed to register with EDD as required by CUIC Section 1086 and the failure was due to either intentional disregard or intent to evade.

3. CUIC Section 1127 Description

Under CUIC Section 1127 when the Director is not satisfied with the return made by an employing unit, EDD may make an assessment for the additional amount due. If the deficient return filed is due to negligence or intentional disregard, add a penalty of ten percent to the assessment.

4. Application of CUIC 1127 Penalty

- Each quarter must be considered separately in applying penalty under CUIC Section 1127.
- The penalty under CUIC Section 1127 is not divisible if only one assessment is levied in a quarter. However, the Section 1127 penalty is divisible if more than one assessment is levied for a quarter.

5. Negligence

Title 22, California Code of Regulations Section 1127-1(a) defines negligence as follows:

“Negligence is the failure to exercise the degree of care which a reasonably prudent person under similar circumstances would exercise in the performance or observance of a duty. The failure to act may, but need not, be caused by carelessness or oversight.

6. Intentional Disregard

Title 22, California Code of Regulations Section 1127-1(b) defines intentional disregard as follows:

“Intentional disregard means to purposely or deliberately pay little or no attention to a required action.”

I. PENALTY DETERMINATION - CUIC SECTIONS 1128(a) AND 1128(b)

Under CUIC Section 1128(a), if the employer fails to file a return or report, or files a deficient return or report, and it is found that any part of the deficiency is due to fraud or intent to evade, a penalty of 50 percent will be added to the assessment. This penalty is in addition to the penalties provided pursuant to Section 1126 and 1127.

CUIC Section 1128(b) provides that an additional fifty (50) percent penalty (in addition to the CUIC 1128(a) penalty) will be added if the employer paid wages and failed to provide information returns as required under Section 13050 of the CUIC, or Sections 18637 or 18638 of the Revenue and Taxation Code. This penalty shall be in addition to any penalties under CUIC Sections 1126, 1127, or 1128(a). Each quarter will be considered separately when CUIC Section 1128 penalty is applied.

The CUIC Section 1128 penalty may be charged on assessments levied under CUIC Section 1137. It can also be included in CUIC Section 1735, if the penalty was originally assessed against the employing unit.

J. CUIC SECTION 1128.1

CUIC Section 1128.1 authorizes EDD to penalize an individual or business entity if it is determined that the individual or business entity exchanged (laundered) money on behalf of an employer and the individual or business entity was aware that the employer intended to use the cash proceeds of the exchange to conceal the payment of wages. The “exchanger” may be assessed a penalty equal to 100 percent of the contributions assessed against the employer paying the cash wages.

K. PENALTY DETERMINATION – CUIC SECTION 1135

1. Description

Under CUIC Section 1135, if an employing unit fails to pay an assessment made by EDD on or before the date the assessment becomes final, a penalty of ten percent of the delinquent contributions will be added (unless a timely petition was filed). The addition of CUIC Section 1135 penalty is mandatory. There are no provisions for waiver of this penalty.

2. Jeopardy Assessment

When a jeopardy assessment is levied under CUIC Section 1137, penalty under CUIC Section 1135 is applicable. Pursuant to CUIC Section 1221, an assessment levied under 1137 is final immediately. CUIC Section 1135 penalty is charged if the assessment is not paid or security for payment is not provided within 30 days of service of the jeopardy assessment.

L. FALSE STATEMENT PENALTY- CUIIC SECTION 1142

If EDD finds that any employer or any employee, officer, or agent of any employer, when submitting facts concerning the termination of a claimant's employment, willfully made a false statement or representation, or willfully fails to report a material fact concerning such termination, then the CUIIC Section 1142 penalty will be charged. The penalty will be charged against an employer of the claimant in an amount not less than two nor more than ten times the weekly benefit amount.

M. PENALTIES COVERING ELECTIVE COVERAGE AND UNDER THE IMMIGRATION REFORM ACT

1. Elective Coverage

EDD will charge a penalty, if applicable, under CUIIC Sections 1112, 1126, 1127, or 1128 when contributions required by the elective coverage provisions of the CUIIC are delinquent.

2. CUIIC Section 2128 Waiver of Penalty

Notwithstanding any other penalty provision, if an employer notifies EDD that an assessment issued after April 30, 1987 includes the wages of an undocumented worker, who with statements of earnings provided by the employer, is seeking legalization status under the Immigration Reform and Control Act (IRCA), then all penalties relative to those wages will be deleted from the assessment. The employer is also immune from civil or criminal prosecution under the CUIIC with regard to those wages.

3. Exceptions

CUIIC Section 2128 will not apply when an employer withholds personal income tax or state disability insurance contributions and fails to remit them to the EDD.

This waiver does not apply to workers applying for naturalization or for wages of other workers or for periods other than those provided by the employer and necessary for documentation of legal status under IRCA.

TAX AUDIT GUIDELINES

CHAPTER XII

CLOSING INTERVIEW

A. CLOSING INTERVIEW

1. Purpose

The audit/investigation findings, work papers, and supporting documents are discussed with the employer, or the employer's representative to:

- Identify any undisclosed facts and resolve disputed points.
- Explain fully all proposed adjustments.
- Attempt to obtain concurrence and payment.

2. Instructing the Employer

During the discussion of audit results, the auditor will advise the employer of the proper reporting of payments for personal services. At the close of the audit, the auditor will also provide the employer with the following forms:

- The Information Sheet: Reporting and Payment Following an Assessment for Misclassified Workers (DE 231 MW).
- Notification of Employer's Right to Review File (DE 105 or DE 105SA).

3. Disagreements Noted

Any disagreement with the audit results on the part of the employer will be identified and fully explained on the DE 108A, Audit Report. The auditor will note in the audit report whether or not the employer intends to file an appeal. If the employer does not concur with the audit findings, a pre-assessment conference should be offered.

4. Proposed Notice of Assessment or Credit (PNA)

Auditors will prepare and provide a PNA to the business' principals for discussion during the closing interview at any time the audit results in adjustments to the employers account, unless the adjustments are all credits. If the adjustments are all credits, auditors will prepare and provide a PNA only if it is requested by the employer.

The auditor should review the balance due on the Proposed Notice of Assessment and/or any returns obtained during the audit or investigation with the employer, and ask for payment.

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4. Proposed Notice of Assessment or Credit (PNA) (cont.)

The auditor should advise the employer of the following advantages of prompt payment:

- Ten (10) percent penalty savings under Section 1135, CUIC.
- Interest savings.
- Tax credit offset under FUTA.
- Possibility of a reduced employer contribution rate (cut off July 31).
- Avoidance of possible impairment of the employer's credit rating upon recording or filing a Notice of State Tax Lien.
- Avoidance of the added charge of a release fee for each Notice of State Tax Lien recorded against the debtor.
- Costs incurred for involuntary collection action will not be added to the debtor's liability.
- Avoidance of possible loss of state income tax refunds. The Department may put indebted employers on the FTB offset list and have refunds redirected to EDD to pay tax liabilities.

5. Verification and Explanation of Existing Account Problems

The auditor will explain to the employer any existing liabilities, report delinquencies, or other issues with their account.

B. PRE-ASSESSMENT AND POST-ASSESSMENT CONFERENCES

1. Objectives of the Pre-Assessment and Post-Assessment Conferences

The objective of an assessment conference is to resolve the differences and/or disputed issues to the point that:

- Agreement is reached, or
- The assessment and/or petition process should proceed.

2. Pre-Assessment Conference

A pre-assessment conference will be offered to the employer on all change audits (both concurrence and non-concurrence). If the employer accepts the offer of a conference, the auditor will arrange the conference between the employer and the Area Audit Program Manager and/or Supervisor. The pre-assessment conference will give all parties the opportunity to discuss the issues which resulted in the audit adjustment, and any points of differences in a non-concurrence case. The auditor will inform the employer that a petition for reassessment must be filed within 30 days of the assessment notice date (10 working days for jeopardy assessments) and that each individual assessment must be petitioned separately.

3. Post-Assessment Conference

A post assessment conference will be offered if an employer, who had previously concurred with the audit findings, later disagrees with the assessment and files a petition for reassessment or a claim for refund:

4. Conference Leader's Responsibilities

The conference leader's responsibilities, when conducting a pre-assessment or post-assessment conference are to:

- Provide the employing unit with a fair and courteous opportunity to present its statement of facts and views on the issues.
- Make certain that all pertinent facts are included in the record and that they are considered in arriving at the determination.
- Explain fully to the taxpayer the conclusions reached and the reasons.

5. Conference Report

An assessment conference report will be prepared after each conference. The report will include the date of the conference, names and titles of the persons present, and will set forth the facts and conclusions reached with respect to each issue.

6. Conference Not Held

If the conference was not held (e.g. employer refused the offer, the employer failed to attend, etc.), the reasons must be explained in Section 8c of the DE 108A, Audit Report.

TAX AUDIT GUIDELINES

CHAPTER XIII

AUDIT WRITE-UP/RULING LETTERS

A. AUDIT REPORT (DE 108A) - OVERVIEW

1. Purpose

The auditor will prepare a report for every completed audit. The audit findings will be recorded on the DE 108A and include the following:

- The employer's compliance with the Department's reporting requirements.
- Audit exceptions.
- Potential complaints or problems.
- Audit findings.
- Employer was advised of EDD's findings and future actions, as the result of these findings.
- Statutes supporting the findings.
- Employer's concurrence or non-concurrence with the findings.
- Information to assist with the collection of current or future liabilities.

2. DE 108A, Audit Report

The DE 108A Audit Report has been designed for use in all audits. The WinAAP DE 108A, Audit Report will be used for all audits conducted using the Laptop computer unless "special circumstances" would prohibit its use. When using the manual DE 108A, the auditor may attach additional pages if additional space is required to expand the audit report.

The following are the nine sections of the DE 108A, Audit Report:

- Entity Examination
- Records
- Payroll Test Narrative
- Misclassified Workers
- Scope of Audit
- Audit Differences

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Chapter XIII

- Penalties
- Post-audit Discussion
- Financial Data

B. RULING LETTERS - OVERVIEW

1. General

A ruling is a written determination issued to an employer or potential employer which, interprets or applies the CUIIC to a situation discovered during an audit or investigation. Ruling letters are written to insure uniform and consistent application of the law.

2. When may a Ruling Letter be Issued

A written ruling may be issued in the following situations:

- An employer requests a written ruling.
- The employer does not concur with EDD's findings.
- A new or amended determination is made on the status of an employing unit, employment, employer, contributions or wages.
- A claim for refund is denied.
- EDD determines that a unity of enterprise (horizontal) exists.
- A written ruling is necessary or desirable.

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C. RULING LETTERS - CONTENT

1. Elements of a Ruling Letter

Ruling letters will contain the elements listed below:

Element	Description
Introductory Paragraph	This paragraph will thank the employer for their cooperation during the audit or investigation, if applicable. However, if the ruling letter is issued for another reason, the introductory paragraph will briefly outline what is to be more fully discussed in the remainder of the letter.
Body of Letter	<ul style="list-style-type: none">• One or more paragraphs will be used to describe the:<ul style="list-style-type: none">- Nature of the business- Services reported by the employing unit- Services and/or individuals not reported• The letter will include a complete statement of the facts, as developed and supported by the audit or investigation<ul style="list-style-type: none">- Include facts that support both EDD's position and the employer's position.- Conclusions are not to be substituted for facts in the ruling letter.• The author will not rely on other rulings for the statement of facts. No two cases are identical.

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Element	Description
Body of Letter (cont.)	<ul style="list-style-type: none"> If the ruling letter is issued for reasons other than an audit or investigation, the brief statement in the introductory paragraph will be amplified point by point in the body of the letter.
Statement of Law	<p>One or more paragraphs will be used to identify the applicable provisions of the law. CUIC sections should be paraphrased or quoted as necessary to identify the authority for the determination. Staff may also use language from prior tax decisions to support their determinations.</p> <p>Whenever a horizontal unity of enterprise status issue is encountered, the ruling letter must provide a complete statement of facts to support each factor (unity of control, unity of operation, and unity of use). They will also cite CUIC Section 135.2 and CUIAB Precedent Tax Decision P-T-358.</p> <p>When dealing with employment status issues that are addressed in Title 22, California Code of Regulations (Sections 4304.1, et. al.), the auditor will cite the appropriate regulation and how the facts of the case relate to the regulation.</p>
Conclusion	<p>One or more paragraphs will be used to apply the facts of the case to the law and to draw an appropriate conclusion. The applicability of PIT withholding will be included especially when statutory employment is found to exist. The conclusion will also contain a specific statement that the letter is an EDD ruling.</p>

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Element	Description
Administrative Remedies	The ruling letter will contain a statement regarding the employing unit's administrative remedies, if applicable. This paragraph should also reference the Notification of Petition and Request for Case File (DE 2250) for the employer's petition rights.
Person to Contact	A final paragraph may be added to provide the name and telephone number of the audit supervisor. If the employer has any questions regarding the audit or investigation, or requires an explanation of the ruling letter, the supervisor familiar with the case will best be able to provide an explanation.

2. Other Required Information

All ruling letters will also contain the following specific information:

- Date issued.
- Name and telephone number of the author will be shown in the upper left corner.
- Account number and name of the employer.
- Return address of the AAO.
- Typed name and title of the Area Audit Program Manager.

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TAX AUDIT GUIDELINES
CHAPTER XIV
NOTICE OF ASSESSMENT

A. OVERVIEW

1. Introduction

An assessment is a notice to an employer or individual of taxes and/or penalties owing under provisions of the CUIC. The employer or individual has the right to appeal an assessment to the California Unemployment Insurance Appeals Board (CUIAB). Assessments are issued under the provisions of the CUIC, commencing with Section 1126 of Chapter 4, Article 8.

2. Basic Requirements

Each notice of assessment must:

- Be in writing;
- State in the body thereof that it is a Notice of Assessment;
- Identify the employing unit to which it refers;
- Show the period to which the assessment relates;
- Explain the basis for the assessment and state the sections of the CUIC under which the assessment is levied;
- Show the amount of contributions assessed and penalty and interest charged.

3. Notice to Employer

EDD issues assessments on one or a combination of the following forms:

- DE 2176 (Employer Account Statement) - This is a multi-purpose form generated by the Tax Accounting System (TAS) and mailed from Sacramento. The form is used to issue notices of assessment to employers and to advise of return/payment delinquencies.
- DE 107A - Notice of Assessment or Credit Made - This is a manually prepared and generated Notice of Assessment. This preprinted form is generally issued by an AAO when a DE 2176 cannot be used. The DE 107A can be modified for billing purposes to a "Statement of Amounts Due."
- DE 107PC (Notice of Assessment - Personal Computer) - This is a locally prepared assessment issued by an AAO using the office personal computer. This form may be used when a DE 2176 cannot be issued timely.

B. ASSESSMENT CRITERIA UNDER CUIC SECTIONS 1126 AND 1127

EDD will assess an employer under CUIC section 1126 when no return has been filed with respect to a calendar quarter for which contributions are delinquent.

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Chapter XIV

When the Director is not satisfied with any return made by an employing unit, an assessment will be levied for additional amounts due under CUIC Section 1127. The additional amounts will be computed based upon facts contained in the return and/or any other information available.

C. TIME LIMITATION FOR MAKING ASSESSMENTS - CUIC SECTION 1132

1. Introduction

With some exceptions, the time limitations for making assessments are contained in CUIC Section 1132. Actions by EDD will be taken on or before the last working day which falls within any statutory limit unless waiver or extension has been obtained.

2. Application

The criteria below identify when assessments under CUIC sections 1126, 1127, 1137, 1184, 1733, or 1735 can be made.

REASON	SECTION	TIME LIMITATION AND AUTHORITY
Failure to file a return due to fraud or intent to evade.	1126, 1137, 1735*	None. CUIC Section 1132
Failure to file a return without good cause. Fraud or intent to evade does <u>not</u> exist.	1126, 1137, 1735*	Anytime up to eight years after the last day of the month following the close of the calendar quarter during which the contribution liability included in the assessment accrued. CUIC Section 1132.
Failure to file a return and good cause exists.	1126, 1137, 1735*	Anytime up to three years after the last day of the month following the close of the calendar quarter during which the contribution liability included in the assessment accrued. CUIC Section 1132.

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REASON	SECTION	TIME LIMITATION AND AUTHORITY
Filed a deficient return. Fraud or intent to evade does <u>not</u> exist.	1127, 1137	Anytime up to three years after the last day of the month following the close of the calendar quarter during which the contribution liability included in the assessment accrued or within three years after the deficient return is filed, whichever period expires the later. Section 1132.
Filed a deficient return. Fraud or intent to evade exists.	1127, 1137, or 1735*	None. CUIIC Section 1132.
Failure of successor to comply with provisions of Sections 1731 and 1732.	1733	No statutory limitation.
Erroneous Refunds	1184	Within three years from the date the refund was made. CUIIC Section 1184.

*See Special Application for Section 1735 below.

3. Special Application Under CUIIC Section 1735

In accordance with the provisions of CUIIC Section 1132, the statute of limitations for CUIIC Section 1735 assessments will begin to run from the last day of the month following the close of the calendar quarter in which liability accrues against the responsible person, or within three years after a deficient return is filed, whichever is later. Liability accrues against the responsible person on any delinquency date that the responsible person willfully failed to pay contributions or withholdings.

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4. Excess Wage Calculation

When the provisions of CUIC Section 1132 are applied, wages paid for employment prior to the statutory period of an assessment will be included in computing the annual taxable wage limitation.

D. WAIVER OF STATUTE OF LIMITATIONS

1. Introduction

The employing unit may waive the statutory limitation established under CUIC Section 1132 or may consent to its extension. Extension of Time for Making Assessments (DE 1977) is used for this purpose. The DE 1977 also serves as a claim for credit or refund of any overpayment discovered in the periods covered by the extension.

2. Voluntary Reporting Beyond the Statutes of Limitations

If, during the course of an audit or investigation, an employer desires to file voluntarily for periods beyond the three-year statute of limitations, the reports will be accepted and processed as self- assessments, regardless of whether contributions are paid or unpaid.

E. JEOPARDY ASSESSMENTS, CUIC SECTION 1137

1. Introduction

The Director may issue an assessment under CUIC Section 1137 if the collection of any contributions will be jeopardized due to delay. A determination as to whether jeopardy due to delay exists will be based upon the facts in each case. The audit or investigation report will justify the issuance of the assessment under the jeopardy provisions.

CUIC Section 1137.1 provides:

“A jeopardy assessment may be made only upon finding by the director, based upon probable cause, that any of the following conditions are met:

- (a) The employing unit is insolvent,
- (b) The employing unit has transferred, or is about to transfer, assets for less than fair market value, and by so doing has rendered, or is likely to render, itself insolvent.
- (c) The employing unit has been dissolved.

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- (d) Any person liable for the employing unit's contribution, or any owner, officer, director, partner, or other person having charge of the affairs of the employing unit has departed or is about to depart the State of California and that the departure is likely to deprive the director of a source of payment of the employing unit's contribution.
- (e) Any person referred to in subdivision (d), or the employing unit, is secreting assets or is moving, placing, or depositing assets outside of the state for the purpose of interfering with the orderly collection of any contribution. The moving, placing, or depositing of assets outside of the state which constitutes a regular business practice and which does not in any way deplete the assets of the employing unit shall not be deemed to be interfering with the orderly collection of any contribution under this subdivision.
- (f) The assessment to be issued against the employing unit or an individual includes a penalty under subdivision (a) of Section 1128 or Section 1128.1."

2. Ruling Letter

The CUIC Section 1137 assessment will be issued with a ruling letter, signed by the Area Audit Program Manager, stating the reasons why the assessment was levied under jeopardy. The ruling letter will include statements that:

- (a) The assessment attached is a jeopardy assessment;
- (b) The assessment is delinquent immediately and EDD will pursue collection action at once;
- (c) An additional penalty of 10% will be added if the assessment is not paid or a deposit or bond is not posted, within 30 days of the date that the assessment is issued;
- (d) The employer may file a petition for reassessment within 10 days of the date the assessment is issued if he/she disagrees with the assessment or wishes to challenge the propriety of issuance of a jeopardy assessment;
- (e) Filing a petition for reassessment does not stay collection action, unless the assessment is paid or the employer posts a bond or deposit in the amount determined by the Director (which normally will be the total amount of the assessment);
- (f) Specify the amount of the deposit;
- (g) State how and where to file the petition for reassessment;

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3. Expedited Hearing

Jeopardy assessments **require** an expedited hearing procedure pursuant to CUIC Section 1221.

4. Justification of Jeopardy not Found

If the ALJ or CUIAB, after a preliminary hearing, finds no justification for the assessment having been levied under CUIC Section 1137, the assessment will automatically convert to one levied under Section 1126 or 1127, as applicable.

5. New Issue

In order to protect EDD's interests, a jeopardy assessment may be issued against an employer for the same amount and covering the same period as a prior assessment issued under another section of the CUIC, whenever a new issue arises jeopardizing EDD's position.

Example:

EDD levied an assessment under CUIC Section 1127 against XYZ Co. XYZ Co. petitioned the assessment and prior to the hearing requested escrow clearance. A new issue arose when the petitioner applied for the escrow clearance; therefore, a jeopardy assessment may be issued for the same liability included in the prior assessment under CUIC Section 1127.

Note: AAOs may levy assessments under CUIC Section 1137 when collection of the liability may be jeopardized, regardless of whether a petition for reassessment was filed against the first assessment.

6. Administrative

In order to preserve an employer's administrative rights in the above example, do not apply CUIC Section 1136 to the original assessment (i.e., if the jeopardy assessment was not petitioned).

7. Current Quarter Hybrid

Jeopardy assessments may also be issued when it is determined that the liability for the current quarter, which is not yet delinquent, is to be established. When the Department finds that "collection is in jeopardy due to delay," EDD will establish the contributions not yet delinquent. An ALJ cannot extend the finality date of a jeopardy assessment for any reason.

F. ISSUING ESTIMATED ASSESSMENTS

1. Introduction

Estimated assessments will be levied under CUIC Section 1126 and/or Section 1127. These assessments will be based on information in the Director's possession.

2. Reasons for Estimated Assessments

An estimated assessment may be issued for various reasons, including:

- Incomplete or inadequate records;
- No return was filed for a period during which it is reasonable to believe that wages were paid;
- An excessive amount of time would be required to calculate the assessment based on actual figures, e.g. 1099 forms, invoices, cash disbursements, etc.

3. Source of Estimate

Estimated subject wages may be based on any information in the Director's possession or that may come into the Director's possession of the amount of wages paid for employment.

4. Proposed Assessment to Employer

Notifications that an estimated assessment will be issued may be made by sending the employer a "Proposed Assessment". The explanation on the proposed assessment should include the possibility of adjustment if appropriate records are provided to EDD.

G. ADJUSTING ESTIMATED ASSESSMENTS

1. Cancellation or Adjustments

CUIC Section 1136 provides that the Director may cancel or reduce an erroneous assessment in the following cases:

- Where no petition for reassessment has been filed.
- Where a petition for reassessment is filed, if the cancellation is made prior to the mailing of a decision of the ALJ.
- Where a petition for reassessment has been filed and an order or decision of an ALJ or of the CUIAB has been issued on any grounds not on the merits, if the CUIAB approves the cancellation.

2. Return or Report After Assessment

The issuance of an estimated assessment often results in the employers filing the delinquent return/report. For lien priority reasons, it may be appropriate to retain the original assessment. The appropriate action to be taken when a report/return is filed after an estimated assessment was issued depends on several factors:

- (a) **When** the return/report was filed; i.e. either before or after the finality date of the assessment.
- (b) Whether the return/report is **paid** or **unpaid**.
- (c) Whether the return/report is **signed** or **unsigned**.
- (d) Whether the contribution amounts shown on the return/report are **equal** to, **less** than, or **more** than the assessed amounts.

H. MEMORANDUM ASSESSMENTS

1. Introduction

In some situations, after a liability has been set up on the records of EDD, a memorandum assessment will be levied to:

- Establish the liability of a person(s) other than the previously known tax debtor, when it is learned that such person(s) is liable for such indebtedness.
- Afford such other person the right to protest the liability determination

2. Penalty Charges

Penalty charges resulting from a CUIC Section 1135 memorandum assessment are posted to EDD records.

3. Payment Application

Any payment received as the result of a memorandum assessment is posted (applied) to the receivable previously established for the known tax debtor.

4. Petition Rights

The usual administrative remedies applicable to assessments are also applicable to memorandum assessments.

5. Alter-Ego

Under the alter-ego theory, EDD will ensure that the person or persons to receive the memorandum assessment were not included as employees in the original assessment.

6. Corporate Officer Memorandum Assessments

Memorandum assessments levied under CUIIC Section 1735 will establish liability against the responsible corporate officer or other person's having charge of the affairs of the debtor corporation or association employing unit.

I. MEMORANDUM ASSESSMENTS - SUCCESSOR LIABILITY

1. Successor Liability Memorandum Assessments

CUIIC Section 1731 imposes a liability on any person or employing unit that acquires the organization, trade or business, or substantially all the assets thereof, of the debtor employer. The section provides that the purchaser must take the precaution of demanding either a statement showing the amount claimed to be due or a certificate showing no tax, penalties, or interest due. The purchaser, who fails to request the Certificate of Release becomes statutorily liable to pay the amount due up to the amount of the purchase price.

2. Definitions

The percentage of assets that must be acquired to constitute "substantially all the assets," is a subject that has not yet been construed by the California Courts.

For the purpose of applying the test of the acquisition of "substantially all the assets," acquisition of less than 80 percent of the assets will impose no liability on the individual or employing unit making the acquisition.

Statement of Amount Due

Upon request of the seller or purchaser, the Area Audit Program Manager or delegated authority shall within 30 days, issue a statement showing the amount of any contributions, interest, and penalties claimed to be due. The failure to issue a certificate or a statement within the period of 30 days shall be deemed equivalent to the issuance of a certificate to the purchaser stating that no contributions, interest, or penalties are due.

J. ASSESSMENTS - SPECIAL SITUATIONS

1. Dual Employer

For assessment purposes a return filed under one account will constitute a "return" filed for both accounts.

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Example:

An employer fails to file a UI-DI return for a quarter, but does file and pay a PIT only return for the quarter. Since the PIT only return is considered to be a return filed for both accounts, any assessment for the UI-DI wages will be levied under Section 1127.

2. Multiple Assessments

It is permissible under CUIC Section 1130 to make more than one assessment for the same reporting period.

Example:

The audit reveals that two types of employee work groups (carpenters and landscapers) were not reported. The employer agrees that the carpenters were its employees, but not the landscapers. The auditor will prepare a separate assessment for each group of unreported employees.

3. Liability is Not Delinquent

When processing some audit and delinquent return cases, it may be necessary to establish a liability for the current quarter, which is not yet delinquent. There are three methods available to the AAO. The auditor will establish the liability under the procedure most applicable to the particular situation per the table that follows:

METHOD	PROCEDURE
Self-Assessment	The AAO may obtain a signed return/report from the employer. Process the return as a self-assessment.
Jeopardy - CUIC Section 1137	When EDD finds that "collection is in jeopardy due to delay," EDD will establish the contributions <u>not</u> yet delinquent using a DE 107A. See Jeopardy Assessment Procedures earlier in this chapter. If a return/report is subsequently obtained, it will be attached to the DE 107A and will be noted thereon, "process for wage detail only." The assessment will be levied under CUIC Section 1137.

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METHOD	PROCEDURE
"Hybrid" - CUIC Section 1127	An assessment under CUIC Section 1127 levied prior to the delinquent date for the quarter is referred to as a "hybrid" assessment. The employer is immediately assessed for contributions which are known to be owing, yet which do not warrant a jeopardy assessment under CUIC Section 1137. The liability becomes final in the same manner as a self-assessment. If CUIC Section 1116 applies, a "hybrid" assessment is not made.

4. CUIC Section 1184 Assessments

CUIC Section 1184 provides that if a refund is erroneously made, an assessment for the amount of contributions will be generated. Penalty and interest will be charged beginning 30 days after the notice of assessment, and interest will accrue until the day of repayment.

K. ASSESSMENTS - FINALITY

1. Application of CUIC Section 1222

Assessments under CUIC Sections 1126, 1127, 1184, 1733, and 1735 are final thirty days (30) after service of the Notice of Assessment unless a petition for reassessment is filed within the thirty-day period. An ALJ may, for good cause, grant an additional thirty days (30) for filing a petition.

2. Extensions Applicable to Assessments

Section 1013 of the Code of Civil Procedure (CCP) provides extensions to the finality date if the notice is served by mail. Section 6707 of the Government Code provides extensions to the finality date if it falls on a Saturday or holiday (Sunday is defined as a holiday for purposes of Section 6707, Government Code). CUIAB Precedent Tax Decision No. P-T-364 sets forth the method of applying the above provisions.

3. Application of CUIC Section 1221

Assessments under CUIC Section 1137 are immediately delinquent. The employer must file a petition within 10 working days of the Notice of Assessment. The amount of the assessment remains immediately due and payable under CUIC Section 1137.

4. Application of CUIC Section 1224

A timely petition for reassessment prevents an assessment from becoming final until:

- Thirty (30) days after the mailing of the order or decision of the ALJ.
- Thirty (30) days after the mailing of the Statement of Amount Due where an assessment is adjusted (i.e., a portion of the petition is granted) by the order or decision of the ALJ.

When a timely appeal to an ALJ's decision is filed with the CUIAB, the finality date of the assessment involved will be extended in accordance with the limitations set in paragraph 4 of this section (i.e. substitute "CUIAB" for "ALJ").

L. CANCELLATION OR ADJUSTMENT OF ASSESSMENTS

1. Application of CUIC Section 1136

CUIC Section 1136 contains authority for cancellation or decrease adjustment of an erroneous assessment that has not been paid. The Director is authorized to cancel such an assessment, even though final, as provided below:

- Where no petition for reassessment has been filed.
- Without the approval of the CUIAB, when an ALJ or the CUIAB has not issued a tax decision on the case.
- With the approval of the CUIAB, when the assessment has been the subject of a tax decision by an ALJ or the CUIAB, but the decision was issued on any grounds not on the merits.

Note: A decision issued not on the merits is a dismissal decision, e.g., employer fails to appear for the hearing (nonappearance); the employer withdraws the petition (withdrawal).

2. When CUIC Section 1136 Does not Apply

CUIC Section 1136 does not authorize cancellation or decrease adjustment of an assessment when the assessment has been the subject of a tax decision issued on the merits by an ALJ or the CUIAB.

CUIC Section 1136 does not apply to paid assessments. However, CUIC Sections 1177 or 1178 may apply.

3. Increasing Adjustments

Assessments which have become final may be increased by levying one or more additional assessments provided the period of assessment is not covered by a civil judgment, a decision of an ALJ, or by a CUIAB decision involving the same wages and the same facts.

If additional assessments are issued for a quarter previously assessed under CUIC Section 1126 and the employer has not filed a return/report, subsequent assessments are also issued under CUIC Section 1126.

4. Adjusting the Assessment at the hearing

Pursuant to CUIC Section 1223, the Department may ask the ALJ to adjust the assessment at the hearing.

5. CUIC Section 1177

CUIC Section 1177, authorizes EDD to make a credit adjustment to a paid and either final or non-final erroneous assessment. CUIC Section 1136 does not apply to paid assessments.

6. New Evidence Submitted

Under the provisions of CUIC Section 410, a decision of the CUIAB is final and binding upon EDD, except for such action as may be taken by a judicial tribunal.

If the employer files an affidavit setting forth new and additional evidence involving the same issues, after a denial decision has been issued on the merits, EDD cannot adjust the assessment. However, an ALJ may grant a new hearing on the basis of the new evidence (CUIC Section 1223). If the request for a new hearing is denied and the assessment has not been paid, the employer can pay the assessment and file a claim for refund with EDD. EDD may either approve or deny the claim. If EDD denies the claim, the employer may petition for review of denial of the claim for refund.

7. New Issue Raised

If the employer raises a monetary issue after the denial decision is rendered involving the status issue only, it is permissible for EDD to correct the amount of the assessment.

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Example:

The employer brings forth travel expense receipts for salesmen held by the ALJ to be employees. Such expenses were not an issue at the hearing and were included in the assessment as unreported wages. It may be necessary to inform the employer to file a claim for refund if the expenses cannot be substantiated.

M. SERVICE OF ASSESSMENTS

1. Purpose

CUIC Section 1131 requires that a written notice of assessment be given to the employing unit.

The notice of assessment must be addressed to the employing unit at its address as it appears on the records of EDD (Section 1206, CUIC).

These requirements apply to both automated assessments as well as to manual assessments.

2. Regular or Certified Mail

Under CUIC Section 1206, an assessment may be served personally or by mail. Service by mail is complete at the time of deposit in the United States mail. If service is made by mail, the following applies:

- If a notice of assessment is in excess of \$1,000 (total of debits not considering credits), or is made under CUIC Section 1137 for any amount, it will be sent by certified mail.
- When a notice of assessment for a partnership that is out of business is in excess of \$1,000 (total of debits not considering credits) or is made under CUIC Section 1137 for any amount, the original assessment and each partner's copy will be sent by certified mail.
- Except under CUIC Section 1137, if a notice of assessment is for \$1,000 or less (total of debits not considering credits), the notice will be sent by regular mail to the Chief ALJ. Petition Review Group will attach copies of the declarations to all copies of the Answer.

3. Billings versus Assessments

Billings are generally issued for penalty and/or interest and for self-assessments when there are no computation errors. However, contribution returns found to contain computation errors are assessed and the employer has appeal rights. Billings are issued under authority of CUIC Chapter 4, Article 7.

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TAX AUDIT GUIDELINES

CHAPTER XV

COMPLETING THE CASE

A. DE 2026 - WAGE REPORT ADJUSTMENT SCHEDULE

1. Use

The Wage Report Adjustment Schedule (DE 2026) is used to:

- Enter wages when no report of wages has been filed.
- Adjust an erroneous report of subject wages.
- Transfer wages that were incorrectly reported under the wrong program (UI-DI, DI-only, or UI only) account number.
- Transfer subject wages and/or PIT withheld from one employer to another, or subject wages and/or PIT withheld incorrectly reported by one employer on behalf of another (split-off).
- Adjust PIT withholding where PIT withheld was not reported to EDD but was reported on the W-2 issued to the employee and/or will be reported by the employer on the W-2 for the current year.

2. Correct Form

Adjustments to the report of wages will be entered on the DE 2026 unless one of the following forms is obtained from the employer:

- Wage Report Adjustment Schedule (DE 678).
- Quarterly Adjustment Form (DE 938).
- Supplemental Return.

3. Identified Wages vs. Unallocated Wages

It is important that the auditor identify, for benefit purposes, the wage adjustments by employee, even if their SSA numbers are not known. Wages that are properly reported and identified ensure the prompt payment of benefits.

TAX AUDIT GUIDELINES

CHAPTER XVI

CASE REVIEW

A. INTEGRATED REVIEW SYSTEM

The main goal of the Field Audit and Compliance Case Review system is to add value to the completed audits, investigations, and obstructed benefit claim assignments. This can be accomplished by ensuring consistent and correct application of the law, regulations, EDD policies and procedures, and the Department of Labor (DOL) audit requirements. The FACD Integrated Review System is managed by FACD Central Operations Audit Section in partnership with the field offices.

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TAX AUDIT GUIDELINES

CHAPTER XVII

WINAAP/TAS & WORKPAPERS/SUPPORTING SCHEDULES

A. WINAAP OVERVIEW

The Windows Automated Audit Program (WinAAP) is a custom software program used on a laptop computer provided to field staff. The WinAAP automates the audit process to eliminate calculation errors and generate standardized reports that are easy to read and interpret.

The WinAAP system is to be used to conduct audits of employers' books and records. The laptop computer will be used to enter financial and nonfinancial data on all audits. Audits may also be prepared by integrating manual schedules with WinAAP audits. An exception to this policy may occur if, in the opinion of the auditor, the audit or a portion of the audit can be accomplished more efficiently manually.

B. OVERVIEW - WORK PAPERS AND SUPPORTING DOCUMENTS

1. Purpose

The primary objective of work papers and schedules is to establish and support the correct reporting of subject wages, taxable wages, and personal income tax withholding. The work papers and automated audit reports will contain all the essential information so that a third party, without consulting with the preparer, can readily understand them. Data that is entered into the laptop should provide an adequate and reliable audit trail.

2. Description

The term automated audit reports as used herein represents the audit test reports printed by the field person during the audit or investigation using the customized computer audit program. They include summary and subsidiary reports listed on the Automated Audit Program (AAP) Reports Menu. Work papers may be used by hearing officers, attorneys, department representatives, as evidence in courts of law, and may be subject to review by the employer since they are an essential part of the audit file.

3. Manual or Automated Schedules

The WinAAP was developed to produce all of the necessary audit schedules for field auditors. There are some instances when a manual schedule is more appropriate or a WinAAP schedule does not efficiently accommodate the documentation needed by the auditor. The auditor should always attempt to complete the audit using the WinAAP; however, when the use of certain manual schedules would result in a more efficient use of audit time, the manual schedule should be prepared.

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4. Required Automated Audit Reports

The following automated audit reports will be included in the audit file:

- Audit Summary Report
- Report of Field Auditor (DE 108A)
- Wage Adjustment Schedule (DE 2026), if required
- PIT Summary Report by Individual (if printed for the employer for preparing DE 938P's)
- Reports, copies of which were provided to the employer during the assignment. (If copies of reports are furnished to the employer, the auditor should also make a copy of that report for the audit file with a notation that "A copy of this report was provided to the employer on mm/dd/yy)
- Other schedules to the extent necessary

5. 1099 Forms Used in Audits and Investigations

When an employer has provided copies of 1099 forms for use in the audit, the forms should be clearly marked "Furnished by Employer" and may be retained in the audit file.

C. WINDOWS AUTOMATED AUDIT REPORTS

The available WinAAP Reports are:

- a) Report of Field Auditor (DE 108A)**
 - 1. Microsoft Word Version
 - 2. Manual DE 108A
- b) Audit Summary Report**
 - 1. Screen (from View only)
 - 2. Print (from Reports or View)
- c) Consolidated Audit Summary Report**
 - 1. Screen (from View only)
 - 2. Print (from Reports or View)
- d) Proposed Notice of Assessment**
 - 1. Screen
 - 2. Print

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- e) **Adjustment Reports** (print only)
 - 1. Gross Wage Test Report
 - 2. Pit Adjustment Report
 - 3. Override Adjustment Report
- f) **Potential Wage Reports**
 - 1. All Payments (print only)
 - a. One Individual
 - b. All Individuals
 - 2. Alphabetical Listing of Payments
 - a. Screen (from View only)
 - b. Print (from Reports only)
 - 3. Individual Summarized by Quarter / Tickler
 - a. Gross (print only)
 - b. Pit (print only)
 - 4. Quarters Summarized by Individuals (print only)
 - a. Active
 - b. Deleted
 - 5. Listing of Employee Numbers and Names
 - a. Screen (from View only)
 - b. Print (from Reports only)
 - 6. DE 2026 Wage Adjustment Schedule
 - a. Screen (from View or Reports)
 - b. Print (from View or Reports)
- g) **PIT Withholding Test** (print only)
- h) **Auditor's Notepad Report**
 - 1. Screen.
 - 2. Print

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D. TAX ACCOUNTING SYSTEM

1. Introduction

The Tax Accounting System (TAS) was developed as a means of automating the Tax Branch accounting systems to handle EDD's increasing workloads because of California's continued economic growth. Tax Branch's responsibilities have grown significantly over the years, from one fund (UI) in 1936 to four major funds today (UI, DI, ETT, and PIT). EDD also has many specialized programs and many different benefit programs. As a result of California's tremendous growth and the Tax Branch's increased program responsibility, previous processing systems and methods did not possess the capacity to provide timely and accurate services to the employer community, the public, or EDD staff.

2. Benefits of TAS

TAS provides the following general benefits to EDD:

- Centralized, Integrated Employment Tax Data Base.
- Improved employer account management.
- Improved timeliness and accuracy of financial accounting records.
- Increased on-line access to employer information.
- Improved accounts receivable information.
- Improved audit selection process.
- Improved use of Tax Branch staffing resources.
- More efficient use of data processing resources.
- Reduced paper flow.
- Centralized procedure help screens.

3. Financial Adjustments

Monetary account adjustments are processed in the Contribution Adjustment Group of the Tax Processing and Accounting Division in Sacramento. There are four exceptions listed in the following tables that allow processing in the local Area Audit Office:

EXCEPTION	CONDITION
Customer Service	Adjustments may be made in the AAO if all necessary documentation is present and a delay would adversely affect the employer or adversely impact public relations.
Delay jeopardizes collection	Adjustments may be made in the AAO if a delay would jeopardize (endanger) collection of the accounts receivable balance.
Telephone adjustments not requiring source documents	<ul style="list-style-type: none"> • AAO staff may transfer a payment to a related or duplicate account. If more than two payments are involved, the employer should be instructed to send documentation to CAG. • A mismarked deposit coupon (DE 88) may be transferred to another account at the point of origin if the payment was intended for and claimed by the account to which the payment is being transferred. AAO staff can cancel penalty and interest for the DE 88 payments.

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EXCEPTION	CONDITION
<p>Field Audit and Compliance Division (FACD)/Collection Division (CD) initiated adjustments</p>	<p>During the processing of an audit, investigation, and/or a collection case, the following specific account adjustments may be processed in the AAO:</p> <ul style="list-style-type: none"> • Estimated assessments necessary to clear delinquencies on cases assigned to FACD and CD. • Cancellation or adjustment to FACD and CD initiated estimated assessments. • Assessments or credits on audit or investigation cases assigned to FACD and CD units. • CUIIC Section 1733/1735 assessments. • Claim for Adjustment or Refund of Personal Income Tax (DE 938P) adjustments should always be processed in the AAO. If they are received in CAG, they will be mailed to the appropriate AAO.

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TAX AUDIT GUIDELINES

CHAPTER XVIII

REFUNDS AND CREDITS

A. OVERVIEW

CUIC Sections 1176 through 1185 provide the authority to issue refunds and/or credits on overpayments.

EDD establishes refunds and/or credits once an overpayment is found to exist. An overpayment exists when an employing unit pays more than the amount actually due.

B. METHODS OF CLAIMING REFUNDS OR CREDITS

1. Establishing Credits/ Refunds

The employing unit may file a claim for refund or credit by writing a letter to EDD with the required information or by filing a claim for refund or credit using an EDD form.

The letter should include the following information:

- Request for refund or credit
- Account number
- Specific grounds on which the claim is based
- Period covered
- Amount claimed
- Date of payment/credit

The letter should be signed by the employer or the employer's agent.

2. TAX AND WAGE ADJUSTMENT FORM (DE 678)

The Tax and Wage Adjustments Form (DE 678) is designed to allow the employer to adjust a prior quarter's information. The DE 678 is the preferred form to use when filing a claim for refund or credit.

3. Amended Returns

Amended or corrected returns reflecting lesser amounts than previously reported in subject/taxable wages or contributions are considered to be requests for credit/refund.

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4. Extension of Time for Making Assessments and a Claim for Refund or Credit (DE 1977)

Extension of Time for Making Assessments and A Claim for Refund or Credit (DE 1977) serves as a claim for refund or credit of any overpayment discovered in the periods covered by the extension. If the employing unit discovers a possible refund or credit near the time for the statute of limitations to apply, the employer should be advised to file a DE 1977. The filing of Form DE 1977 allows the employer additional time to file a claim. The form must be submitted to EDD prior to the expiration date of the quarter(s) included in the extension.

C. TIME REQUIREMENTS FOR CLAIMING REFUND OR CREDIT

1. CUIC Section 1178

To be timely, a claim for refund or credit must be filed or discovered within the time limits prescribed under CUIC Section 1178, and is the later of the following periods:

- Three years from the last day of the calendar month following the close of the calendar quarter for which the overpayment was made, or
- Six months after an assessment levied by EDD becomes final, or
- Sixty days from the date of overpayment.

2. Example

An assessment is levied on May 3, 1993, for the quarter 92-4. The employer does not file a petition for reassessment and pays the assessment on June 30, 1994. The applicable time limits per CUIC Section 1178 are:

- Normal statute for quarter 92-4 - three years from the last day of the month following the close of the fourth quarter 92-4 is January 31, 1996.
- Date of Assessment is May 3, 1993, and the assessment becomes final on June 3, 1993 - six months after would be December 2, 1993.
- Date of payment is June 30, 1994 - sixty days from date of payment is August 29, 1994.

Therefore, January 31, 1996 is the last timely date to file a claim for refund.

D. DENIAL OF A CLAIM FOR REFUND

1. Introduction

A denial of a claim for refund is a written ruling by EDD. The AAO is responsible for issuing the denial of a claim.

2. Finality - Petition for Review

A denial of a claim for refund or credit issued by EDD is final 30 days from the date of service unless a petition for review is filed. The provisions of Section 1013, Code of Civil Procedure, apply if the denial is by mail.

A petition for review must be filed within 30 days of service pursuant to CUIC Section 1222.

3. Finality - Claim Deemed Denied

CUIC Section 1222 provides that if EDD fails to serve notice of approval or denial in writing within 60 days from the date of the claim, then the claim may be deemed denied. Once the claim is deemed denied, the employing unit or person may file a petition for review.

E. AUTHORIZATION REQUIRED FOR ASSIGNMENT OF REFUNDS

CUIC Section 1177 authorizes refunds to the employing unit making the overpayment or to its successor, administrator, or executor.

F. PROTEST OF CONTRIBUTION RATE

1. Timely Protest under CUIC Section 1034

An employer may file a written protest of any statement of charges, or credits and charges, to his account within 60 days after the date of mailing or within an additional 60 days if good cause is determined by EDD to exist.

The employer is not required to pay the charges in order to file a protest. Payment is only required if the protest is to be considered a claim for refund.

2. Protest Claim for Refund under CUIC Section 1037

In order for a timely protest to constitute a claim for refund, the employer must pay contributions at the rate given in the latest statement of account.

EDD will then consider any protest of a rate to be a claim for refund of all payments made on and after the date on which the protest was filed, and applicable to the period for which such rate was established.

If EDD allows the protest, the overpayments will be refunded or credit allowed. An overpayment made prior to the protest will be processed as any other overpayment.

If EDD denies the protest, the employer will be notified of the denial in accordance with CUIC Section 1035.

A separate denial of the claim for refund is not required.

G. CUIC SECTION 1179.5 - PETITION CONVERSION

CUIC Section 1179.5(a) provides that full payment made before an ALJ issues a decision on a petition for reassessment will constitute the filing of a claim for refund that is deemed denied. Therefore, the petition will automatically become a petition to review a denial of the claim for refund by the Director.

CUIC Section 1179.5(b) provides that full payment made before the CUIAB issues its decision on an appeal from an ALJ's decision on a petition for reassessment will constitute the filing of a claim for refund that is deemed denied by the Director and affirmed by the ALJ. Therefore, the appeal will automatically become an appeal from an ALJ's decision upholding the denial of the claim for refund.

In either situation, the full payment must be received after the petition or appeal has been filed, but prior to the issuance of a decision by the ALJ or CUIAB on a petition for reassessment.

It is to the employer's advantage to pay the assessment in full prior to the issuance of the decision on a petition for reassessment in order to save time and costs and by-pass some of the administrative appeal procedures. This is especially important if the employer wishes to pursue the case in court.

Example:

The employer pays the assessment in full prior to the issuance of the CUIAB decision on the petition for reassessment. The CUIAB decision denies the employer's petition. Since CUIC Section 1179.5 converts the decision into a petition to review a denial of the claim, the employer may then appeal directly to the court system.

H. OVERPAYMENTS/CREDITS WHICH INCLUDE EMPLOYEE CONTRIBUTIONS

1. Employer Refund of Erroneous Deductions

CUIC Section 1178 and Title 22, CCR, Section 1178-1, require that an employing unit refund erroneous employee deductions. The credit or overpayment may be established during the course of an audit/investigation or by a claim for refund filed by the employer.

2. One Year Allowed

The employing unit must complete the refund to the employee within one year after the date of the allowance of the credit or approval of the claim for refund, or no credit will be allowed for employee contributions nor will the employer or employee contributions, penalty, or interest be refunded.

I. TYPES OF EVIDENCE REQUIRED FOR REFUND OF EMPLOYEE CONTRIBUTIONS

1. Satisfactory Evidence

The employing unit must provide satisfactory evidence that the employee deductions have been refunded or that the employer has been unable to make the refunds (or a portion of them).

2. Notice of Overpayment and Claim for Refund (DE 938C)

TAS automatically generates a Notice of Overpayment and Claim for Refund, DE 938C, to notify the employer of potential erroneous employee deductions when the amount of DI reported exceeds the amount calculated on TAS (based on the amount reported by the employer as DI taxable wages). The DI and PIT overpayment amounts are placed in trust funds awaiting employer response.

Evidence of the refund of erroneous employee deductions must be submitted within one year from the date of the DE 938C sent by EDD.

J. WHEN REFUND PROCEDURE FOR ERRONEOUS DEDUCTIONS IS NOT REQUIRED

1. Bankruptcy Court Action

Refunds of erroneous employee deductions is not required if the employing unit has been adjudicated bankrupt.

2. Refund Not Required

Refund of erroneous employee deductions is not required if the employing unit is unable to make such refund by reason of a pending court action.

3. Voluntary Plan - No Refund

No employer under a Voluntary Plan will be required to make refunds of erroneous employee deductions on Voluntary Plan wages subsequently determined to be paid for services not in employment.

K. EMPLOYEE DEDUCTIONS - VOLUNTARY PLAN

1. Voluntary Plan Refund

A Voluntary Plan employer will be required to refund erroneous deductions if the deductions from wages were in excess of the taxable limitation, or were at a rate greater than the state DI rate.

2. Deductions Less Than Applicable DI Rate

If employee contributions required to be paid under an approved Voluntary Plan are less than the state plan DI rate, the employer will be permitted to deduct contributions on wages in excess of the taxable wage limitation. The deductions will not exceed the maximum deduction from taxable wages paid per calendar year for an individual employee.

Example:

<u>Tax Year</u>	<u>1995</u>
DI Rate	1.0%
Taxable Wage Limitations	\$31,767
Maximum Deduction	\$317.67

A Voluntary Plan employer may, for example, deduct two tenths of one percent (.002) on the first \$50,000 of taxable wages. This method would be acceptable because the amount withheld is \$100, which is less than the maximum DI deductions of \$317.67 for the calendar year 1995.

L. SPECIAL SITUATIONS

1. Credits/Unity of Enterprise

When Unity of Enterprise (UE) is applicable, a credit from one ownership may be applied to a liability existing for a separate ownership providing there is a continuity of ownership between them.

Example:

A partnership went through the following ownership changes, AB to BC to CD. Ownership CD files a claim for refund for overpayments existing in CD and BC.

The Department representative will process the claim in the following manner:

- Accept claim for refund from CD as a claim covering both the overpayments in BC and CD.
- Separate refund warrants will be issued for BC and CD.

NOTE: Since there is no continuity between AB and CD, the credit will not be applied without written authorization of the ownership for which the credit exists.

2. Second Claim Petition for Review Denied

If an employer files a second claim for refund of an overpayment on which the CUIAB has previously denied a petition for review, the employer will be informed that the case has been closed by the CUIAB tax decision, and that EDD does not have jurisdiction to consider the second claim for refund. Audit staff will inform the employer that the next step is to file a civil action.

3. Payment Under Protest

When a payment is made under protest, the employer is informed by letter that the payment itself does not constitute a claim for refund.

A Claim for Refund, DE 638, is not included with the letter sent to the employer. The DE 638 may be misleading to the employer in that it generally includes instructions for refunding erroneous wage earner deductions, or implies that an overpayment has been made, or both.

4. Erroneous Assessments

If it is determined that an assessment is excessive or erroneous and adjustment or cancellation is in order, such credit adjustments will be processed under CUIC Section 1136.

M. OVERPAYMENTS UNDER CUIC SECTION 1176/BENEFIT OVERPAYMENTS

When processing assignments involving cash refunds or credit adjustments of contributions, the SDI Refund Unit will disclose any possible overpayments under CUIC Section 1176 and will initiate the required adjustments.

If the AAO has knowledge, or if the employer furnishes evidence or has direct knowledge of the fact that an employee affected has drawn benefits, or has received a refund under CUIC Section 1176, audit staff will:

- Instruct the employer to exclude the employee from the refund.
- Include comments in the audit/investigation report, explaining the benefits drawn or the refund made under CUIC Section 1176. The name and social security account number of the employee affected and the period during which benefits were drawn or the date on which a refund was made will be noted.
- Exclude DI contributions from the TAS entry documents.

TAX AUDIT GUIDELINES

CHAPTER XIX

INVESTIGATIONS

A. DEFINITION AND OVERVIEW

1. Definition

An investigation is an assignment in which single or multiple issues and problems are resolved, or requested data is gathered with respect to an entity's responsibilities, requirements, or status under the CUIIC and Title 22, California Code of Regulations. An investigation assignment can be converted to an audit.

2. Purpose

The purpose of an investigation is to:

- Resolve specific issues involving compliance with statutes enforced by EDD.
- Promote voluntary compliance.

B. PROOF OF CREDIT

1. Purpose

When an employer, who is subject to the Federal Unemployment Tax Act (FUTA), reports more wages to the federal government than to EDD, the difference must be explained.

2. Request For Explanation

The FUTA Certification Unit in the Tax Processing and Accounting Division may send the employer either a DE 228 (for registered employers) or a DE 190 (for non-registered employers) requesting an explanation of the difference between state and federal wages.

3. Referral of Case

If the employer does not explain the difference within 60 days, the FUTA Certification Unit will refer the case to the appropriate Area Audit Office. If the employer or a responsible person cannot be located, the auditor should advise the FUTA Certification Unit immediately.

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C. BANKRUPTCY, PROBATE, AND ASSIGNMENT (BPA) CASES

1. Introduction

BPA cases are normally handled by Collection Division. These cases must be completed within short time frames as established by bankruptcy rules. If a claim is not filed timely, EDD may be barred from participation in the distribution of the debtors funds.

2. Assessments of the Debtor

Bankruptcy Code Section 362(b)(9) provides, in general, that it is not a violation of the automatic stay to conduct an audit, issue a notice of tax deficiency, make a demand for a tax return, or make an assessment while the debtor is in bankruptcy. Therefore, it is not a violation of the automatic stay for EDD to perform audits, investigations, and/or issue assessments on pre-petition and post-petition liabilities while the debtor is in bankruptcy.

3. Bankruptcy Cases

There are six general classes of bankruptcy in which EDD is involved:

- Voluntary petitions, Chapter 7
- Involuntary petitions commenced under Chapter 7 or Chapter 11
- Restructuring of Debts, Chapter 11
- Adjustment of debts of an individual with regular income, Chapter 13
- Family Farmers, Chapter 12
- Municipalities, Hospitals, School Districts, Chapter 9

4. Probate Cases

Probate cases involve the estates of deceased persons. There are two kinds of estates:

- Testate estates - decedent had a will
- Intestate estates - decedent did not have a will

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5. Assignment Cases

Assignment cases are those which involve a contract entered into by a debtor (assignor) whose assets are placed in trust with a third party (assignee) for liquidation. The assets will be liquidated and the proceeds will be distributed to the creditors.

6. Split Quarters

If an employer continues to pay wages after a bankruptcy petition is filed, it will be necessary to establish the liability of pre-petition and post-petition periods. The return/report or the assessment for a split quarter liability must include the notation "pre-petition". The liability due for periods beginning on the day the bankruptcy petition is filed is the post-petition liability.

7. Procedure

An audit or investigation should be completed if records are available to establish complete wage information.

New Release

TAX AUDIT GUIDELINES

CHAPTER XX

OBSTRUCTED CLAIMS

A. OVERVIEW

1. Definition

An obstructed claim is a request filed by a claimant or by EDD personnel in the local UI/DI benefit office for a reconsideration of EDD's base wage computation, or denial of the initial benefit award. It is also used to determine if an employer-employee relationship existed between the claimant and alleged employer.

2. Possible Adjustments

The claimant or an employer may request:

- Additional wage credits not included in the initial computation.
- Wage credits not reported by the alleged employer.
- Deletion of incorrect wage credits.

The UI/DI office may request determination of the claimant's status, i.e. covered for benefit purposes vs. exempt; employee vs. independent contractor.

B. INVESTIGATION REQUEST (DE 1153)

1. Monetary Investigation

The following chart summarizes how a request for monetary investigation for the establishment of wage credits is originated:

STEP	PROCESS
1	An individual files a claim for unemployment or disability insurance benefits in an EDD benefit office.
2	EDD's data base is accessed to request a recomputation of wages – Unemployment Insurance Notice of Computation (DE 429). This request is automatically sent to the UI or DI Hub office. Each Hub office handles a group of benefit offices for claims processing.
3	The claimant receives a printed copy of the DE 429 which notifies the claimant of the award and wages upon which it was based.
4	If the claimant contends that wages either are omitted or incorrect, a Request for Reconsideration of Initial Computation (DE 455) will be filed through the benefit office.
5	The DE 455 is sent to the Hub office or the Insurance Accounting Division, Insurance Recomputation unit to determine correct wages.
6	If the assignment cannot be cleared by the above units, the obstructed claim investigation is initiated and a DE 1153 is sent to the Area Audit Office (AAO) or the Insurance Accounting Division.

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2. Status Investigation

The following chart summarizes how a request for a status investigation is originated. The purpose of a status determination is to determine if the claimant was in an employment relationship and to establish wage credits (if any) within the base period of the claim:

STEP	PROCESS
1	The UI benefit office mails a Notice of Claim Filed (Form DE 1101CZ) to the most recent employer when a new or additional claim has been filed during the benefit period. The DI benefit office mails the Notice of State Disability Claim Filed (DE 2503) to the last employer. There may be other situations when the UI/DI offices will request a status determination.
2	The employer will enter on the DE 1101CZ or the DE 2503 relevant facts about the claimant's eligibility. If the claimant was treated as an independent contractor, the employer will usually state this.
3	The employer is requested to return the DE 1101CZ or the DE 2503 to the benefit office.
4	When either of the forms generates a status issue, the benefit office prepares a DE 455 requesting a status investigation and establishment of subject wages (if any) and transmits it to the Hub office or IAD/Recomputation Unit.
5	The Hub or IAD/Recomputation Unit prepares a DE 1153 entering the information requested by the benefit office and transmits the DE 1153 to the AAO.

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If the AAO determines that an employer-employee relationship existed and if the employer is a base period employer, the employer may appeal the determination upon receipt of the Notice of Determination (DE 1080). If the AAO determines that there is no employer-employee relationship, the claimant is notified and may appeal the determination. (This procedure applies only to UI claims.)

Regarding DI claims, if it is determined that there is no employer/employee relationship, the claimant is disqualified and notified of his or her appeal rights.

C. EMPLOYER PROTEST

1. Protesting the Determination

A Notice of Claim Filed and Computation of Benefit Amounts (DE 1545) is sent to the base period employer(s) after the claimant receives his/her first benefit payment. If the employer is a base period employer he/she may protest the claimant's eligibility by following the procedures included with the DE 1545.

2. Time Limits

The time limit for the employers to respond to a DE 1545 concerning a ruling or eligibility information is 15 days from the mailing of the DE 1545, or 20 days, if the DE 1545 concerns the accuracy of wages used in the computation of the claim.

3. Statement of Charges to Reserve Account

An employer may protest reserve account charges as reported on the Statement of Charges to Reserve Account (DE 428T) (mailed annually in September and October) if he/she believes them to be in error. Written protest must be made within 60 days of the mailing of the DE 428T. Instruction for filing protests accompany the DE 428T.

D. REIMBURSABLE EMPLOYERS

1. Background

Reimbursable employers pay the actual cost of benefits paid. For example, if the Notice of Determination (DE 1080) holds the claimant eligible and the reimbursable employer files an appeal which results in a reversal of the decision, this employer will still pay the actual benefits paid.

New Release

2. Appeal Rights

Last and base period employers on reimbursable financing do not receive rulings as they have no reserve accounts. However, reimbursable employers submitting timely eligibility information are entitled to determinations which may result in a hearing.

Employer/claimant questions involving the benefit appeal process should be referred to the UI field offices.

3. Example

A consultant files a claim against his/her reimbursable employer. The reimbursable employer will receive a Notice of Claim Filed (DE 1101CZ) (last employer) and/or Notice of Wages Used for UI Claim, Reimbursable (DE 1545R) (base period employer). For the reimbursable employer which is the last and base period employer, the DE 1545 will show wages, but not charges. If the employer raised a status issue on the DE 1545R that the UI office could not resolve, the UI office will prepare a Recomputation Request (DE 455) and transmit it to the applicable Hub. The Hubs will issue the DE 1153 and transmit it to the applicable AAO. The AAO will respond to the UI office with its determination. The field office adjudicator will prepare the Response to Employer Communication (DE 4614) or the Notice of Determination (DE 1080). The DE 1080 contains the appeal rights and will be mailed to the employer if EDD holds that there is an employer-employee relationship. If the employer appeals and receives a favorable decision (for example, claimant is held not be an employee), the base period wages will be backed out. However, the employer will be billed for its percentage of the benefits paid to the claimant.

4. SEF Assignments

All obstructed claims involving school districts (K through 12) and community college districts will be investigated by the School Employees Fund. SEF does not investigate four-year colleges and universities (State and private), any DI claims, or local public entity accounts. If the AAO receives an obstructed claim involving an SEF employer and it is not a status determination, it will be immediately transferred to SEF. If SEF cannot clear the obstructed claim by telephone, the AAO may be requested to conduct an investigation. The AAO will obtain the information requested and return a report of the investigation to SEF.

E. ESTIMATING WAGES

1. Industrial Welfare Commission (IWC) Orders

The IWC Orders regulate wages, hours, and working conditions of employees in specific occupations.

2. Minimum Wages

Whenever an employer does not have records of wages paid, EDD will not consider wages to be less than the required minimum, as established by law.

F. IRREGULAR WAGE PAYMENTS, DE 2026 PREPARATION

1. CUIC Sections 1282 and 2657

CUIC Sections 1282 and 2657 provide that if the remuneration of an individual is not based upon a fixed period or duration of time, or if the individual's wages are paid at irregular intervals, the wages for any week or for any calendar quarter, for the purpose of computing an individual's right to benefits, shall be determined as reasonably similar to those which would prevail if the individual were paid his wages at regular intervals.

2. Procedure

For benefit purposes, irregular wage payments will be allocated to the period during which the payment was earned. The application of CUIC Section 1282 and 2657, will be limited to obstructed claim assignments.

Example:

- Base period of claim 98-4 through 99-3.
- Claimant was employed from October 1, 1998 through December 15, 1999.
- Claimant received an unreported payment of \$12,500 on December 31, 1999 based on services through December 15, 1999.

Wages will be allocated as follows:

98-4	99-1	99-2	99-3
\$2500	\$2500	\$2500	\$2500

TAX AUDIT GUIDELINES

CHAPTER XXI

SPECIAL ISSUES

A. TRANSFER OF WAGES/CONTRIBUTIONS BETWEEN ACCOUNTS

The following examples require the transfer of wages and/or contributions between accounts:

- Duplicate accounts.
- An employer erroneously remits contributions under another employer's account number.
- An employer reports under an incorrect type of plan (UI and/or DI and/or PIT).
- Two or more related entities that are functionally united through unity of control, operation, and use, and are each reporting under a separate account number. Under the "Unity of Enterprise" concept (horizontal consolidation), the single employing unit should report under one account number.
- Two or more businesses under separate ownership's report contributions under the same account number. Each entity should use a separate account number for reporting purposes (split-off).

B. TRANSFER OF WAGES/CONTRIBUTIONS - CONSOLIDATED RETURNS

1. Definition

A consolidated return is a return for one quarter which erroneously includes wages paid in another quarter for which a return was not filed. In such case, wages/contributions will be adjusted.

2. Penalty

The consolidated return is considered a return for each quarter. A penalty will be charged under CUIC Section 1112 for any quarters which were not paid timely, unless the employer requests a waiver of penalty and "good cause" is found to exist. Also, in the absence of "good cause", a penalty under CUIC Section 1112.5 will be charged for all quarters where returns were not filed timely.

3. Specific Written Demand

A penalty will be charged pursuant to CUIC Section 1114 if the employer fails to respond timely to a specific written demand for wage detail.

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C. RESERVE ACCOUNT TRANSFER PROCEDURES

1. Introduction

A reserve account may be transferred when the business of a registered employer or a distinct and severable portion of the business has been acquired by another employing unit.

2. Information Requests from Successor Employer

A successor employer who is entitled to a transfer of reserve account may receive information from Contribution Rate Group (CRG) to safeguard their rights and to decide whether the transfer should be requested.

CRG will give the employer the latest balance of the predecessor's reserve account and contribution rate for the following rating period.

3. Methods of Requesting Reserve Account Transfer

A successor may apply for a reserve account transfer by any of the following steps:

- Forwarding a letter containing a request for reserve account transfer.
- Completing an Application for Transfer of Reserve Account (DE 4453).
- Filing its first contribution return after acquisition in the following manner:
 - Paid or unpaid, under the account number of the predecessor.
 - Under its own account number but using reduced rate applicable to the predecessor.
 - As a consolidated return covering both the operations of the predecessor and successor.
 - Split returns together.

4. Rate

If a transfer is made, the rate will apply as of the date of acquisition only if the application was made within 90-days.

5. Specific Information Furnished Applicant

CRG, in response to applications for reserve account transfer, mails the successor the following specific information:

- When the predecessor account contains a negative balance, the form letter Notice of Predecessor's Negative Account Balance (DE 4613) is mailed to the successor.
- In "merger cases", if the transfer of the reserve account balance to the successor will increase the employer contribution rate, a letter is sent advising the successor of the potential tax rate increase.
- If the successor is a new employer and the transfer of the reserve account balance will increase the employer contribution rate, a letter is sent advising the successor of the potential tax rate increase.

In all the above cases, the transfer of the predecessor reserve balance to the successor reserve account is optional; however, once the transfer is made it is final and may not be reversed.

6. Application Made Within 90 days

If the application is made within ninety days after the acquisition date and the parties have submitted all necessary information, the predecessor's reserve account, or a proper portion thereof, is transferred to the successor.

- **New Employer**
If the successor is a new employer, the reserve account and contribution rate of the predecessor is acquired effective on the date of acquisition.
- **Registered Employer**
If the successor is a registered employer, the transfer and any rate change resulting from the transfer will become effective with the beginning of the quarter succeeding the acquisition date. Any change in the contribution rate of the predecessor resulting from such transfer would also be effective with the beginning of that same quarter.

7. Application Made After 90 days

If the application is made more than ninety (90) days after the date of acquisition, the reserve account will be transferred unless one of the following conditions has occurred prior to the application:

- The predecessor account was canceled after the expiration of the three-year period in which no wages were paid in employment, as provided by CUI section 1029.

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- The predecessor has re-entered business and reacquired the reserve account
- The predecessor in a partial acquisition continued to operate a distinct and severable portion of the business.

8. Rate

If the successor is a new employer, the amended contribution rate, if any, will be effective with the beginning of the next quarter after the application date. Prior to that time, the non-rated employer rate would be applicable.

If the successor is a registered employer, any change in rate resulting from the transfer also will be effective with the beginning of the next quarter after the application date.

9. Administrative Remedies

If a transfer of reserve account balance is denied (or granted against the wishes of the predecessor), the employing unit affected may file a petition for review with the CUIAB. The petition must be filed within 30 days after service of the notice of denial or granting of the transfer. The CUIAB may grant a 30-day extension for filing the petition if "good cause" exists.

D. OVERVIEW - HORIZONTAL UNITY OF ENTERPRISE

Horizontal Unity of Enterprise (UE) occurs when two or more separate but related entities operate at the same time, and are functionally united through continuity of control, managerial unity, and common operation goals. This employing unit is assigned one account number and one contribution rate.

E. CUIC SECTION 991 – APPLICATION

1. Introduction

CUIC Section 991(a) and (b) determine whether a payment made in error to a specified entity is considered timely with EDD and not subject to penalty and/or interest.

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2. Application

A CUI Section 991 determination is involved when:

- Payment for contributions is mailed erroneously to an entity specified in CUI Sections 991(a) or (b), or
- Wages subject to the CUI have been reported and paid to another state and timeliness of the payment must be verified.

3. Qualification

To qualify under CUI Section 991, the employing unit must pay EDD within 30 days after receiving written notice of EDD's determination that such payment shall be made. Where "good cause" exists, EDD may extend the period for payment not to exceed an additional 90 days.

4. Personal Income Tax

CUI Section 991 does not apply to PIT withholdings.

5. DI/ETT

Disability Insurance (DI) and Employment Training Tax (ETT) are subject to the provisions of CUI section 991.

F. INTERSTATE RECIPROCAL COVERAGE ARRANGEMENT (IRCA)

1. Definition

An Interstate Reciprocal Coverage Arrangement (IRCA) allows an employer to elect coverage for an individual who customarily performs service in two or more states. The employer, each employee, and each interested state must consent to this election. IRCA's are approved by Audit Section.

2. Requested Forms

Upon request, EDD will send the employer a Instructions for Governing Multi-State Workers (DE 2323) and Title 22 Section 454(a)-1 along with the following forms:

FORM	TITLE
DE 2324	Instructions to Employers Electing Coverage under the CUIC for Those Employees Who Work in Two or more States.
DE 2325	Employer's Election to Cover Multi-State Workers Under the CUIC.
DE 2325A	Employee's Consent to Coverage Under the CUIC

3. Additional Forms

The following forms will be sent upon receipt of completed DE 2325/DE 2325A:

FORM	DESCRIPTION
DE 2326	Form letter for other interested states to transmit copies of DE 2325 and DE 2325A.
DE 2328	Notice to Employees of Unemployment and Disability Insurance Coverage.

4. CUIIC Sections 602/603

Services which are "localized" (CUIIC Section 603) in any state cannot be covered under an IRCA. Services which would otherwise be subject to the unemployment compensation laws of other states by application of the three remaining "employment" tests (CUIIC Section 602) may be covered under the CUIIC through an IRCA.

G. INTERSTATE MARITIME RECIPROCAL ARRANGEMENT (IRMA)

1. Introduction

The purpose of the IRMA is to coordinate between jurisdictions the coverage of persons engaged in maritime services in order to simplify reporting, avoid duplication of contributions, and assure continuous coverage of such individuals. The employer, each employee, and each interested state must consent to this election.

Refer to Title 22, California Code of Regulations, Sections 454(b)-1 through 454(b)-8, for regulations relating to:

- notification of change of jurisdiction
- election of coverage
- effective date of arrangement
- termination of participation in the arrangement.

2. Central Vessel Listing

The State of New York, Department of Labor, has the responsibility for compiling the "Central Listing of Vessels" for all jurisdictions subscribing to the Maritime Reciprocal Arrangement. The list is used to determine liable states on maritime claims. New editions are published about every six months. The listing contains the following:

- Name of Vessel
- Jurisdiction (state)
- Employer
- Dates of Coverage

H. SOLE SHAREHOLDER EXCLUSION

1. Requirements

Under CUIC Section 637.1, an employee may file a Sole Shareholder/Corporate Officer Exclusion Statement (DE 459) disclaiming any rights to DI benefits only if:

- The individual is the "sole" shareholder of a private corporation or the only shareholder other than his or her spouse.

and

- The individual is an employee under CUIC Section 621(a).

2. Sole Shareholder/Corporate Officer Exclusion Statement (DE 459)

The DE 459 is the form used to disclaim DI benefits. However, any statement filed with EDD is acceptable, providing it is signed by the individual and specifically disclaims any rights to DI benefits. When an informal disclaimer is filed, the individual should also complete a DE 459.

3. Approval

The DE 459 is not an application which requires EDD's approval. However, an approval letter will be sent to the individual or corporation advising them of the effective date of the exclusion.

4. Effective Date

CUIC Section 637.1 provides that the election shall be effective on the first day of the quarter in which the statement is filed. The minimum period the statement will be in effect is two complete calendar years.

5. Disclaimer Filed With Return

When disclaimers are filed with the quarterly return (during the month following the close of the calendar quarter), the corporation is liable for DI contributions based on wages paid to the corporate officer/sole shareholder in the previous quarter.

6. Termination

The disclaimer can be terminated in writing by the sole shareholder/officer after two complete calendar years.

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7. Disclaimer Invalid After Effective Date

If a disclaimer becomes invalid because the individual no longer meets the provisions set forth in CUIC Section 637.1, the corporation is liable for DI contributions from the day the requirements of CUIC Section 637.1 are no longer met.

TAX AUDIT GUIDELINES

CHAPTER XXII

ELECTIVE COVERAGE

A. ELECTIVE COVERAGE

The following forms are used in the elective coverage process:

FORM	DESCRIPTION	CUIC SECTION
DE 1PE	Selection of Financing Method and Election to Cover Excluded Services for UI; Only as it Applies to Public Entities under Section 710.	710
DE 3DI	Quarterly Premium Notice for DI Elective Coverage; pre-addressed card; mailed quarterly; not stocked in AAOs. Shows name, address, SSA number and quarterly wage and contribution liability.	708(a), 708(b), and 708.5
DE 3DI-I	Notice of Increase in the Contributions for D.I. Elective Coverage; DI only information concerning reportable "wages" and contributions for employers and self-employed individuals; mailed yearly with fourth quarter DE 3DI; not stocked in AAOs.	708(a), 708(b), and 708.5
DE 3F	Instructions for Reporting Wages and Contributions; section 708(a) CUIC; stocked in AAOs and CO.	708(a)
DE 1375	Notice to Employees; Elective coverage application; poster distributed when application for prospective coverage is filed under CUIC sections 701, 702, or 703.	701, 702, 703
DE 1375A	Notice to Employees: Application for termination of Elective Coverage Agreement for UI-DI; poster distributed when termination under CUIC sections 701, 702, or 703 is approved.	701, 702, 703

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FORM	DESCRIPTION	CUIC SECTION
DE 1375C	Notice to Employees; Disability Insurance Elective Coverage, notice of application under CUIC section 702.5.	702.5
DE 1375D	Notice to Employees; Termination of Elective Coverage Agreement for Disability Insurance; poster distributed when termination of DI coverage is approved under CUIC sections 702.5, 709, 710.4, or 710.5.	702.5, 709, 710.4, 710.5
DE 1378	Application for Elective Coverage of Employers in employment exempted by the CUIC; Form designed specifically for prospective coverage elections under CUIC section 702 but also adapted for use when prospective coverage is requested under CUIC sections 701, 703, or 710.	701, 702, 703, 710
DE 1378A	<p>Application for Elective Coverage of Employers UI & DI under CUIC section 708(a); stocked in AAOs and CO; distributed on request with Disability Insurance pamphlets, For Your Benefit (DE 2320) (UI) and DE 2515 (DI). All active partners who elect simultaneously must be included on a single form.</p> <p>Also, employer should be given DE 3F with application.</p>	708(a)
DE 1378DI	Registration Form-Elective Coverage-DI; Application for DI only Elective Coverage under CUIC sections 708(b) and 708.5; stocked in Amos, EDD benefit offices and Audit Section; distributed on request with an information pamphlet Disability Insurance (DE 2515) (DI). Each electing partner must file a separate form.	708(b) and 708.5
DE 1378F	Information sheet concerning potential liability for Unemployment Insurance Benefits when electing the reimbursable method of financing under CUIC. Stocked in AAOs.	801, 802, 803

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FORMS	DESCRIPTION	CUIC SECTION
DE 1378J	Application for DI Elective Coverage of Exempt Family Employees under CUIC section 702.5. Stocked in AAOs.	702.5
DE 1378K	Information sheet concerning Elective Coverage under CUIC section 702.5 for exempt family employees. Stocked in AAOs.	702.5
DE 1378L	Information sheet for Elective Coverage of Disability Insurance.	709
DE 1378M	Application for Elective Coverage of Disability Insurance Only; Local Public Entities under CUIC section 709.	709
DE 1378N	Application for Elective Coverage of Disability Insurance Only for Employees of a Public School Employer under CUIC section 710.4 or a Public Agency Employer under CUIC section 710.5. Election is by bargaining unit or appropriate group.	710.4, 710.5
DE 1378P	Information sheet for Elective Coverage of Disability Insurance Only of Public School Employer under CUIC section 710.4 or a Public Agency Employer under CUIC section 710.5. Stocked in AAOs.	710.4, 710.5
DE 1857A	Notice to Employees; Employee coverage for Unemployment and Disability Insurance. Stocked in AAOs.	702, 709
DE 3816A	Letter of Approval of Election	708(a)
DE 3816DI	Letter of Approval of Election under CUIC Sections 708(b) and 708.5, CUIC; sent by CO. Informational pamphlet Disability Client Handbook (DE 5137) sent with letter.	708(b) and 708.5
DE 3817	Standard letter of approval for DI Elective Coverage for Exempt Family Employees.	702.5

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