

# Tax Audit Guidelines

# Tax Audit Guidelines

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# Tax Audit Guidelines

## Chapter I

### Audit Program

#### **A. Tax Branch**

The Employment Development Department (EDD) Tax Branch works with employers to collect California's employment taxes and data to support the employment security, child support, and Personal Income Tax (PIT) programs.

The EDD Tax Branch administers the collection, accounting, auditing, and enforcement functions for Unemployment Insurance (UI), Employment Training Tax (ETT), State Disability Insurance (SDI), and PIT. The UI, ETT, and SDI tax collections are used to support programs administered by the EDD.

The EDD Tax Branch is committed to provide excellent service to California employers and benefit claimants by increasing voluntary compliance with employment tax laws through education, simplified reporting processes, and the promotion of fair business competition. The EDD Tax Branch strives to operate a fair, efficient, and effective payroll tax system.

The EDD Tax Branch consists of four divisions: Field Audit and Compliance Division, Collection Division, Tax Processing and Accounting Division, and Tax Support Division.

#### **B. Field Audit and Compliance Division (FACD)**

The Field Audit and Compliance Division (FACD) consists of three program areas that share the common goal of working with the employer community to increase voluntary compliance:

- Audit Program
- Compliance Development Operations
- Central Operations

##### **1. FACD Mission**

Through strategic and collaborative efforts, FACD provides education, assistance, and tax enforcement to promote fair competition, safeguard workers' rights, and maximize voluntary compliance.

##### **2. FACD Core Values**

FACD employees are stewards of the public trust and adhere to the highest ethical standards. The FACD core values help to ensure the customers are served with fairness, honesty, and integrity. The FACD core values guide

FACD employees in the daily operations and projects. The core values are equally important and include:

- Service
- Adaptability
- People
- Care and Respect
- Communication
- Leadership
- Teamwork
- Accountability
- Citizenship

### **3. Audit Program**

The California Unemployment Insurance Code (CUIC) and the Government Code authorize the EDD to conduct employment tax audits and investigations of businesses operating in California. Payroll tax audits and investigations help provide education outreach to employers regarding their state employment tax obligations and ensure that workers are covered for social benefits that the EDD provides. The Audit Program is also responsible for providing education to employers by conducting cost free seminars and outreach events.

The Audit Program is divided into Northern and Southern Regions. The two regions have a total of nine Area Audit Offices (AAO).

### **4. Compliance Development Operations (CDO)**

CDO serves as the primary lead development organization for the Audit Program. CDO leverages technology and works in partnership with other agencies to develop leads which include review and analysis of allegations of non-compliance received from informants and participation with other state and federal agencies in on-site business inspections.

CDO is divided into the Northern Underground Economy Section and Southern Underground Economy Section.

### **5. Central Operations**

Central Operations provides support to the Audit Program and CDO through training, legislative analysis, audit case review, strategic planning, computer related assistance, centralized attendance, and other administrative services. Central Operations serves as the liaison between other divisions within Tax Branch, other EDD branches, and the California Unemployment Insurance Appeals Board. Central Operations is divided into the Audit Section and Technical Services Section.



# Tax Audit Guidelines

## Chapter II

### Tax Auditor Authority, Duties, and Responsibilities

#### A. Authority

##### 1. Executive Orders

The Tax Branch delegations of authority are contained in the EDD's Executive Orders.

Executive Order No. 12 (16 series) amended June 16, 2009, provides the authority for specified officers or employees, as delegated by the Director of the EDD as authorized representatives, to administer oaths and issue subpoenas under the California Unemployment Insurance Code (CUIC). The order provides that pursuant to the CUIC and sections 11180-11182 of the Government Code, the specified representatives within the Field Audit and Compliance Division (FACD) are authorized to administer oaths and issue subpoenas to compel attendance of witnesses and the production of books, papers, correspondence, memoranda, and other records as described.

Executive Order No. 20 (16 series) amended June 16, 2009, provides to any of the specified officers or employees delegated by the Director of the EDD as authorized representatives considered necessary for the administration of this Department, the authority to require records, reports, returns, and contributions from employers under the provisions pursuant to sections 1085 - 1088, 1092, 1093, 13043 and 13050 of the CUIC.

##### 2. Authority Under the California Government Code

The following sections of the California Government Code grant 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 11180.5** provides that at the request of the Attorney General, a department may assist in conducting an investigation of any unlawful activity that involves matters within the jurisdiction of the department. Any documents or information acquired from the investigation may be disclosed to another department if that department agrees to maintain the confidentiality of the documents or information as required.

- **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 information or evidence of any unlawful activity discovered.
- **Section 11182** authorizes the Director of EDD to delegate the powers conferred by the California Government Code to any officer of the Department authorized to conduct the investigation or hearing.

### 3. Authority Under the CUIC

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

- **Section 301** provides that the EDD is vested with the duty of job creation activities; making manual computations; determination of contribution rates and the administration and collection of contributions; establishment, administration, and transfer of reserve accounts; making assessments and the administration of credits and refunds; and approving elections for coverage.
- **Section 311** authorizes the Director of the EDD to appoint assistants subject to the provisions of the California Government Code and may delegate functions to any of the officers or employees.
- **Section 317** requires the Director of the EDD to maintain a field investigating staff, whose function shall embrace investigation throughout the state of violations of the CUIC to the end that its provisions are more adequately and strictly enforced.
- **Section 329** provides that the Director of the EDD shall serve as Chairperson of the Joint Enforcement Strike Force on the Underground Economy provided for in Executive Order W-66-93. The strike force shall include, but not be limited to, representatives of the EDD, the Department of Consumer Affairs, the Department of Industrial Relations, the Department of Insurance, and the Office of Criminal Justice Planning. Other agencies that are not part of the administration, such as the Franchise Tax Board, the California Department of Tax and Fee Administration, and the Department of Justice, are encouraged to participate in the strike force.

The strike force shall have the following duties:

- (1) Facilitate and encourage the development and sharing of information by the participating agencies necessary to combat the underground economy.
- (2) Improve the coordination of activities among the participating agencies.
- (3) Develop methods to pool, focus, and target the enforcement resources of the participating agencies in order to deter tax evasion and maximize recoveries from blatant tax evaders and violators of cash-pay reporting laws.
- (4) Reduce enforcement costs wherever possible by eliminating duplicative audits and investigations.

- **Section 13000** provides that the EDD 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 section 13020.
- **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 subdivision (c) and sections 13025 and 13026 of the CUIIC. 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 pursuant to 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 18663 of the Revenue and Taxation Code.

For each payroll period on or after November 1, 2009, the sum shall agree with the changes made to section 18663 of the Revenue and Taxation Code.

- b. The EDD, upon request, may permit the use of accounting machines to calculate the proper amount to be deducted and withheld from wages, if the calculation produces an amount substantially equivalent to the amount of tax required to be withheld under section 13020(a) of the CUIIC.

Withholding shall not be required by this section with respect to wages, salaries, fees, or other compensation paid by a corporation for services performed in California for that corporation to a nonresident corporate director for director services, including attendance at a board of directors' meeting.

## **B. Auditor Responsibilities**

The auditor has the following specific responsibilities:

- The auditor will make 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. EDD Representative**

The auditor will conduct themselves in a professional and courteous manner.

### **2. Employer Contact**

The auditor will acquaint the employer with the provisions of the programs administered by the EDD along with its rules and regulations. The auditor will not express advice or opinions about any law except the CUIA.

#### **Objectivity**

If the employer disagrees with the audit findings, the auditor will discuss the proposed adjustments and provide information that supports their determination. If the employer still disagrees, the auditor will suggest that a conference be held with the auditor's supervisor.

### **3. 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.

### **4. 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 their supervisor for disposition.

### **5. Disclosure of Facts**

During the assignment, the auditor will disclose all relevant facts with respect to the auditor's determination. The auditor's report will include all facts, both those that support the auditor's determination, as well as those that support the employer's position.

### **6. Conflict of Interest**

The auditor must inform his or her supervisor of any possible conflict of interest that he or 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.

### **7. Incompatible Activities**

Pursuant to section 19990 of the Government Code, 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 the EDD.

## 8. Auditor's Liability

Section 860.2 of the Government Code 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.

Section 860 of the Government Code defines tax for purposes of section 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 CUIIC provide authority pertaining to the responsibilities of employers, as well as those businesses which do not believe they are employers. Employing units are required to:

- Maintain Records

**Section 1085** of the CUIIC and section 1085-2 of Title 22, CCR, require employers to keep a true and accurate work record for all workers and their status including wages paid to each worker and such other records as the Director of the EDD may require.

**Section 1085-5** of Title 22, CCR, 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.

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

- Make Records Available

**Section 1092** of the CUIIC requires that employer records shall be open to inspection and shall be subject to being copied by EDD representatives at any time during the business hours of the employing unit.

**Section 2105** of the CUIIC states that it is a violation of this chapter 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 of the EDD or the Director's authorized EDD representative at any reasonable time during business hours.

## Tax Audit Guidelines

### Chapter III

#### Case Assignments

#### **Introduction**

Case assignments are initiated for various reasons, are analyzed according to established guidelines, and are set up based on specific procedures.

#### **A. Reasons to Initiate 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 California Unemployment Insurance Code (CUIC).
- Determine if the employing unit has made the proper withholding for California personal income tax as required by the CUIC and has accurately reported and remitted the withholdings to the Employment Development Department (EDD).
- Resolve Unemployment Insurance (UI) and State Disability Insurance (SDI) benefit claim discrepancies to ensure the accurate payment of workers' benefits.
- Resolve wage-earner claims for refund pursuant to section 1176 of the CUIC.
- Establish liability under bankruptcy or probate, and assignment for benefit of creditors' actions.
- Assist other states in resolving discrepancies in reporting to their state.
- Ensure compliance in industries known to be incorrectly reporting or not reporting specific wages or services.
- Pursue leads provided by the public and other offices within the EDD.
- Pursue investigations provided by the EDD's Compliance Development Operations (CDO).
- Assist compliance staff in reconciling system generated estimated assessments issued by the EDD for failure of the employing unit to file returns.
- Follow-up on written requests from workers to determine whether an employment relationship exists between the worker and the employing unit.

#### **B. Case Assignment Guidelines**

Each case will be reviewed and analyzed when received or initiated in the Area Audit Office (AAO).

## 1. Chronological History

The field auditor will maintain a chronological history of case action(s) which will include, but is not limited to, the following:

- Reason for the assignment.
- Details regarding the nature of the discrepancy and/or controversy involved.
- Information to be determined or verified.
- Additional facts which would assist in completing the assignment.
- Recent correspondence between the EDD and the employing unit.
- Employer contacts.
- Date field work first began.
- Date the assignment was completed and sent to review.

## 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 along with a *Pre-audit Questionnaire* (DE 996Q) and *Information Sheet: Employment Tax Audit Process* (DE 231TA). A 15-day follow-up will be established for each DE 996 letter.

The DE 996 provides:

- Name, address, and employer payroll tax account number of the employer.
- The purpose for the audit and the period covered by the audit.

The DE 996Q is a questionnaire in which the employer indicates when and where the records will be available, who to contact for the appointment, and their contact information. Additional questions regarding the business are also included in the DE 996Q. The DE 996Q should be returned within **14 calendar days**.

### 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 or designated location to conduct an audit. If the appointment is not convenient, the employer has the option of rescheduling.

## **D. Transferring an Assignment**

### **1. Introduction**

An assignment is normally transferred when it is determined that the employer is no longer located within the Area Audit Office's (AAO) geographical jurisdiction or the assignment was sent to an incorrect AAO.

### **2. Contact Transferee Area Audit Office**

Before transferring the assignment, the transferee AAO may be contacted 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 are typically scheduled after the DE 996 is received 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, phone, or in person. The employer will be given a reasonable amount of time to gather the requested books and records.

In order to set an appointment date, time, and place, the auditor may contact the employer or employer's authorized representative listed on the DE 996 by phone. The call should address the following:

- The reason for the call.
- The purpose of the audit.
- Request for records (refer to the DE 231TA for a list of records needed).
- Request that the employer and/or the 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 an entity's books and records, conducted in accordance with auditing standards and procedures. Generally, EDD employment tax audits cover a three-year period, comprising the 12 most recently completed calendar quarters. However, in some situations, such as when no returns were filed, the audit period may be longer. The EDD conducts both Department of Labor (DOL) audits and status audits.

A DOL audit must meet minimum requirements as defined by the DOL and additional requirements established by the EDD. The DOL administers the nationwide Unemployment Insurance (UI) program and establishes procedures and guidelines that every state is required to follow. The employer account must be subject to UI to be designated as a DOL audit. In addition to administering the statewide UI program, the EDD is also responsible for the State Disability Insurance program, Employment Training Tax, and the reporting of withheld California Personal Income Tax. Therefore, the EDD also requires other payroll tests in addition to those mandated by the DOL.

A status audit is limited in scope compared to a DOL audit. A status audit is an assignment in which the primary focus is to ensure that employees eligible for benefit coverage and subject payments for services under the CUIC are accurately reported to the EDD.

###### **2. Purpose of an Audit**

The purpose of an audit is to:

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

##### **B. Classification of Audits**

###### **1. Verification versus Request**

The DOL 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 Assignments**

Verification audit assignments are usually based on no knowledge of a specific subject employer. An employer may be selected for a verification audit based on:

- Size of the payroll
- Number 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 need to audit a specific subject employer. This type of audit is generally initiated as a result of a benefit, status, or delinquency assignment.

## Tax Audit Guidelines

### Chapter V

#### Subpoenas

##### **A. Subpoenas - Overview**

###### **1. Types**

The EDD is authorized to issue an administrative *Subpoena/Subpoena Duces Tecum* (DE 297) pursuant to sections 11181 and 11182 of the California Government Code (Executive Order No. 12).

###### **2. Definition of Subpoena**

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

###### **3. Use of Subpoena**

An administrative subpoena may be used by the 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 the EDD and directed toward 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 the 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 California Unemployment Insurance Appeals Board (CUIAB) has the authority to require attendance by a witness or the production of records at a tax or benefit hearing before an Administrative Law Judge (sections 407 and 1953 of the CUIIC; Title 22, California Code of Regulations, section 5058). The CUIAB will issue the subpoenas needed at the request of the EDD.

**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 the 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).
- 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 an 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 <b>until</b> it is determined that the limited partner has possession of the records.	“A” as a limited partner for “X”, a limited partnership.
General Partnership	<p>Service will be made on the individual partners and 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"> <li>• One copy of the subpoena must be given to each partner.</li> </ul> <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"> <li>• Only one copy of the subpoena needs to be given.</li> </ul>	<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>

**1. Addressing and Serving the Subpoena (cont.)**

Entity	Directions	Example
Corporations Domestic and Foreign	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.  The 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.	If the individual is an officer of the corporation having possession of the books and records for the domestic (or foreign) corporation XYZ Inc.  "To J. H. Smith, President"
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 will be served individually and as the trustee for a bankrupt employer.	"J. Jones, individually and doing business as Trustee in the 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."

**2. Identification of Records**

The preparer of the DE 297 will 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 the DE 231TA as a guide, with the exception of state and federal income tax returns. Judicial precedent precludes the 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 sections 1985 and 1987.5 of the Code of Civil Procedures (CCP). 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 section 311 of the CUIA. Neither code section requires an affidavit.

### **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:

- Prepare a typed *Memorandum* (DE 16), which will be forwarded to the Collection Division, Special Procedures Group, with the subpoena attached.
- The Declaration of Service on the reverse side of the subpoena must be completed and signed by the person who served the subpoena. If the subpoena was made by mail under section 415.30 of the CCP, attach a copy of the *Acknowledgement of Receipt of Subpoena* (DE 302C) to show proof of service as required by section 417.10 of the CCP.

The typed DE 16 must contain the following:

- A statement that the person was served and failed or refused to attend or produce papers as required by the subpoena.
- The date(s) on which the person was served.
- Summary of the dates the person was contacted and the nature of conversations that took place while attempting to secure the information.
- A detailed and factual explanation of the reasons for initially issuing the subpoena.

Upon receipt of the DE 16, the Special Procedures Group will forward the subpoena and factual statement to the Attorney General.

In most cases, the Attorney General will write a letter to the individual. If the individual fails to make satisfactory arrangements after receipt of the letter, the Attorney General may ask the Superior Court for an order requesting the individual show cause as to why the individual should not be held in contempt of court.

## Chapter V

Failure to respond to this order may result in the issuance of a bench warrant for the individual's arrest. The AAO has two options after forwarding the report and subpoena to the Special Procedures Group.

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**

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

No employee of the 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 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 (LLC), association, trust, or any other legal entity.

**3. Customer Authorization**

The *Customer Authorization* (DE 298C) (section 7473 of the Government Code) 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 *Customer Notification* (DE 299C) (section 7473 of the Government Code) 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 an *Explanation of Records Review* (DE 300C) (section 7473 of the Government Code) if the employer/customer requests a written explanation of the reason(s) for the records review.



## Tax Audit Guidelines

### Chapter VI

#### Preparing for the Audit

##### **A. Planning**

It is important that the auditor take time to anticipate the types of issues or problems which might be encountered and review the account for any outstanding issues that can be resolved during the audit. The auditor will review sections of the California Unemployment Insurance Code and any reference materials for applicable status issues and procedures prior to conducting the audit.

##### **B. Books and Records to be Examined**

The accounting records maintained by businesses vary and the auditor will determine what records need to be examined based on the employers accounting system and internal controls. The following are some of the records that may be requested during the audit:

- Check registers
- General ledger and journal
- Payroll records
- Cash disbursement records
- Required licenses
- Written agreements
- Federal/state income tax returns
- Federal Form 1099 and/or state Form 599
- *Wage and Tax Statement* (Form W-2)
- *Employer's Withholding Allowance Certificates* (Form W-4 and/or DE 4)

## Tax Audit Guidelines

### Chapter VII

#### Entrance Interview and Entity Examination

##### **A. Interview Procedures**

The entrance interview is an important phase of the audit process since it establishes the foundation of the auditor's relationship with the employer. It is critical that the employer understands the purpose of the audit and the need to review their business records. The entrance interview must be conducted fairly and objectively to avoid creating an employer perception that the auditor is conducting the audit with preconceived conclusions. The entrance interview also provides an opportunity to answer any questions that the employer may have regarding filing requirements, deposits, statutory withholdings, and any issues/concerns related to the EDD. During the entrance interview, the auditor should attempt to gain a better understanding of the overall business operations and the types of services provided by acknowledged employees. This will allow the auditor greater insight into how and why alleged independent contractors are utilized and to enable the auditor to make correct status determinations.

Entrance interview procedures require the auditor to:

- Meet with the principal(s) of the organization and/or person(s) responsible for the accounting operation.
- Explain the purpose of the visit and the extent of your examination of the payroll and general accounting systems.
- Give the employer/designated representative(s) an estimate of the amount of time it will take to conduct the audit.
- Provide the employer/designated representative(s) with pertinent forms and documents related to the audit process.
- Ask pertinent questions based on the type of business or entity using the *Audit Report* (DE 6580) as a guideline.
- Request direct access to individuals in the company that are knowledgeable and able to speak to the day-to-day operations (e.g., accountant, payroll supervisor, or controller).
- At the conclusion of the entrance interview, inform the employer/designated representative(s) 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 records is the same as that found during the course of the audit. For example, if the EDD's records indicate the business operates as a sole proprietorship, the auditor will verify that it actually operates as such, rather than as a partnership, corporation, or other type of entity.

### **2. Commence Date/Unity of Enterprise (UE) Verification**

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

### **3. Business Existence Verification**

Whenever possible, the auditor should visit the business location to verify that the business exists.

### **4. Discussion with the Employer**

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

## Tax Audit Guidelines

### Chapter VIII

#### Examination of Books and Records

##### **A. Acknowledged Payroll Tests**

###### **1. Introduction**

The auditor will reconcile the acknowledged payroll reported to the Employment Development Department (EDD) 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 and reported by or on behalf of the employer.

###### **2. Selection of Representative Quarters**

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

##### **B. Verification of Payroll Posting System**

###### **1. Purpose**

Verification of the payroll posting system is to verify the accuracy and completeness of the employer's payroll posting system. This review will confirm the level of reliability for verifying reported wages.

###### **2. Verification of Payroll Posting System Methodology**

Within the EDD's accounting system, verification of the payroll posting system is completed on a quarterly basis within the four representative quarters. The auditor schedules the acknowledged payroll from the employer's accounting records and compares it to the employer's copy of the wage report and to the amounts posted to the employer's tax account in the EDD's accounting system. If differences are found, then the differences are reconciled to determine the correct amount of payments to be reported.

##### **C. Verification of Taxable Wages**

###### **1. Purpose**

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

Section 930 (for Unemployment Insurance [UI] taxable wage limits) and section 985 (for State Disability Insurance [SDI] taxable wage limits). If the taxable wage limits are not correctly 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 July 1, 2015, through June 30, 2016, the taxable wage test should cover the period from January 1, 2015, through December 31, 2015.

## **3. Sections 930.1 and 930.5 of the CUIC**

Section 930.1 of the CUIC 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 within the same calendar year. Such wages cannot be used to arrive at the taxable wage limit for Disability Insurance purposes.

In reconciling wages to the taxable limits, consideration must also be given to section 930.5 of the CUIC (predecessor-successor, for both UI and SDI taxable wage purposes).

Out of state wages may be counted toward the UI taxable wage limitations (but not SDI taxable wage limits) if the transferred employee formerly worked in a business acquired by the California employer as set forth in section 930.5 of the CUIC.

## **D. Pit Verification Tests**

### **1. Verify Total California Personal Income Tax (PIT) Withheld**

The California PIT withholding test is performed to ensure that all California PIT withheld from acknowledged employees is properly reported to the EDD. For each quarter in the four quarter test period, the quarterly California PIT withheld totals from the employer's payroll record are entered into the EDD's accounting system. If California PIT was not properly withheld or reported for acknowledged employees, the EDD's accounting system is used to enter PIT adjustments as needed.

### **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 Form W-4/DE 4 Compliance**

Section 4340-1 of Title 22, California Code of Regulations (CCR), sets forth the requirements for employers to submit an *Employee's Withholding Allowance Certificate* (Federal Form W-4) or *Employee's Withholding Allowance Certificate* (State of California DE 4) for verification of PIT withholding status. This regulation relieves employers from submitting Form W-4s or DE 4s to the EDD in most cases and incorporates federal requirements for submitting the remainder.

Pursuant to section 31.3402(f) (2)-1(e) of Title 26, Code of Federal Regulations, if either of the following two conditions exist, the Form W-4 or DE 4 is considered invalid:

- Any alteration of, or unauthorized addition to, a withholding exemption certificate shall be invalid if there is any alteration and/or unauthorized addition made.
- If an employee clearly indicates the withholding exemption certificate is false by either oral statement or by a written statement.

When an employer receives an invalid Form W-4 or DE 4, the employer is not to use it to calculate PIT withholding. The employer must inform the employee that it is invalid and ask for another one. If the employee does not give the employer a valid one, then the employer will withhold PIT as if the employee was single and claiming no withholding allowances. However, if the employer has an earlier Form W-4 or DE 4 for this worker, that is valid, then the employer will withhold PIT based on the earlier form.

## **E. Large Employer**

### **1. Definition of a Large Employer**

The United States Department of Labor (DOL), for each state, defines a large employer as an employing unit subject to UI (including UI-SDI and UI-SDI-PIT employers) who has reported wages paid to 100 or more individuals during the current or preceding calendar year.

### **2. Arranging the Audit Appointment**

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

### **3. Pre-Audit Conference**

During the initial meeting with the employer's authorized representative(s), the auditor will determine if accounting records and management tools are available for use during the audit.

#### **4. Federal Requirements Regarding Electronic Data Processing (EDP) Records**

The 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 section 6001 of the Internal Revenue Code (IRC) and section 1.6001-1 of the Code of Federal Regulations (CFR).

Section 6001 of the IRC 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 prescribe.

Section 1.6001-1(e) of the CFR 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.

The 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 EDD 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 there in.

## Tax Audit Guidelines

### Chapter IX

#### Guidelines for Employment Status Determinations

##### **A. Procedures**

During the audit or investigation process, the auditor is to take the following actions:

- **Explain the Process**  
The auditor will start by explaining the process to determine whether the worker is an employee or an independent contractor. Even though the auditor may have discussed the status determination process during the entrance interview, they should reiterate it when discussing status issues to help the employer understand the process.
- **Gather Information**  
When securing information from the employer, the auditor will gather documentation and ask the employer questions regarding the working relationship with the worker(s) in question. For independent contractors, the auditor will ask the employer why they believe the worker is an independent contractor.
- **Allow the Employer Sufficient Time**  
The auditor must allow the employer a reasonable amount of time to provide pertinent information regarding the working relationship and payments. The auditor should accept the evidence without reaching a conclusion or debating the status issue.
- **Conduct an Exit Interview**  
The auditor must offer an exit interview to the responsible owner or officer of the employing unit. The employer representative may be included in the discussion with the employer. The auditor will discuss the status determination, 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 indicates 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 the California Unemployment Insurance Appeals Board (CUIAB) Precedent Tax decisions, CUIAB decisions, and court decisions which address similar status issues to support the determination and provide copies to the employer.



- Offer a Pre-assessment Conference  
A pre-assessment conference with the auditor's supervisor will be offered to the employer.

Although an auditor may need to deviate from this method in certain situations, every attempt must be made to take these actions when making a status determination.

## **B. The ABC Test**

Beginning January 1, 2020, section 621(b) of the CUIC sets forth the three criteria that are used, subject to certain exceptions, to determine whether an individual is an *employee* or *independent contractor*. Any individual providing labor or services for remuneration has the status of employee rather than an independent contractor unless the hiring entity demonstrates all of the following conditions:

- A) The individual is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact (refer to section 621(b)(1) of the CUIC).
- B) The individual performs work that is outside of the usual course of the hiring entity's business (refer to section 621(b)(2) of the CUIC).
- C) The individual is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed (refer to section 621(b)(3) of the CUIC).

While section 621(b) of the CUIC contains the applicable criteria for most workers, there are some jobs, industries, and contracting relationships listed in Labor Code sections 2776 through 2784 (referred to as exceptions), which the employment factors listed in *S. G. Borello & Sons (Borello)* must be used. Additionally, there are other specific occupations which require the standards set forth in the California Business and Professions Code to be applied.

Reference *Information Sheet: Employment (DE 231)*, for specific information about the ABC test.

## **C. Common Law Test**

For services performed prior to January 1, 2020, whether an individual is an employee will be determined by the applicable common law rules. The primary test in determining whether services are rendered in employment is the right of the hiring entity to exercise direction and control over the manner and means of accomplishing the desired results. In addition to the primary factor, the common law test also considers secondary factors in determining whether the workers are employees or independent contractors.

### **1. Direction and Control**

The auditor's goal in making a common law status determination is to gather sufficient facts so that the entire working relationship can be understood and a proper determination is made. The working relationship is analyzed to determine

if the principal retains the right to exercise direction and control over the services performed by the worker. While the principal may not actually exercise direction and control, the key factor is whether the right of control exists. Strong evidence of control is the principal's right to discharge the worker at will, without cause. If the principal has the right to control the services performed by the worker, whether or not that right is exercised, an employer-employee relationship exists. The primary right of direction and control is discussed in section 4304-1 of Title 22, California Code of Regulations (CCR).

If the auditor cannot determine if the principal has the right to control the services performed by the worker, there are secondary factors that must be considered.

## **2. Secondary Factors**

The secondary factors have different weights in different occupations, therefore, whether an individual is an employee or an independent contractor will depend upon a grouping of factors significant to the occupation at issue. The factors that indicate the worker is an employee are to be weighed against those that point to an independent contractor status.

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 to exercise control, an employment relationship exists. If the facts show that the worker is generally free from the principal'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. Where the method of performing a task is dictated by health and safety regulations imposed by the government, the principal (employer or taxpayer) is not exercising the manner and means of control as an employer. Therefore, implementation of health and safety regulations by a principal is neither evidence of employment nor independent contractor status and are neutral factors when making status determinations. Regulations that are not related to the health and safety of the public and that are implemented by a principal are evidence of employment.

The following table will assist in making an employment status determination. The ten common-law factors are broken down into elements and each element includes characteristics that describe either an employee or an independent contractor.

**Factor 1:** Whether or not the one performing the services is engaged in a separately established occupation or business.

Element	Employee	Independent Contractor
Hiring Assistants	A worker works for a principal who hires, supervises and pays assistants. If a worker hires and supervises assistants at the direction of the principal, he or she is acting as an employee in the capacity of foreman or representative of the principal.	An independent contractor hires, supervises and pays assistants under a contract that requires him or her to provide materials and labor.
Expenses	Payment or reimbursement of the worker's business and travel expenses by the principal indicates control over the worker.	A worker who is paid on a job basis and is responsible for out of pocket expenses is generally an independent contractor. Since the person is accountable to no other person for the expenses, the person is free to work according to his or her own methods and means.
Investment	The furnishing of all necessary facilities by the principal tends to indicate an employment relationship. Facilities generally include equipment or premises necessary for the work, but not tools, instruments, clothing, etc., that are commonly provided by employees in their particular trade.	A significant investment by the worker in facilities used by him or her in performing services for another tends to show an independent status.  In order to be significant, the investment must be real, essential, and adequate.

Element	Employee	Independent Contractor
Profit and Loss	<p>When a worker is insulated from loss or is restricted in the amount of profit they can gain, they are usually an employee. The opportunity for higher earnings, such as from pay on a piecework basis or the possibility of gain or loss from a commission arrangement, is not considered profit or loss.</p>	<p>The possibility of a profit or loss for the worker as a result of his or her services generally shows independent contractor status. Profit or loss implies the use of capital by the worker in an independent business. Whether a profit is realized or loss suffered generally depends on management decisions; that is, the one responsible for a profit or loss can use his or her own ingenuity, initiative, and judgment in conducting the business or enterprise. Factors that affect whether or not there is a profit or loss are whether the worker:</p> <ul style="list-style-type: none"> <li>• Hires, directs, and pays assistants.</li> <li>• Has his or her own office equipment, materials, or other facilities for doing the work.</li> <li>• Has continuing and recurring liabilities or obligations.</li> <li>• Succeeds or fails depending on the relation of his or her receipts to his or her expenditures.</li> <li>• Agrees to perform specific jobs for prices agreed upon in advance.</li> <li>• Pays expenses incurred in connection with the work.</li> </ul> <p>An independent contractor typically can invest significant amounts of time or capital in their work without any guarantee of success.</p>

Element	Employee	Independent Contractor
Works 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 or she works under the control of each firm.	Works 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, from control by any of the firms. The worker determines what is to be done and when it is to be done between clients and also retains the right to accept or reject particular assignments.
Offers Services to the General Public	If a worker performs services for only one person or firm, does not advertise his or her services to the general public, does not hold licenses, or hire assistants, and performs services on a continuing basis only for one person or firm, it is an indication of an employment relationship.	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 assistants, hanging out a <i>shingle</i> in front of his or her home or office, holding business licenses, maintaining business listings in phone directories, or advertising in newspapers, trade journals, magazines, Internet, etc.

**Factor 2:** The kind of occupation, with reference to whether, in the locality, the work is done under the direction of a principal without supervision.

Element	Employee	Independent Contractor
Custom in Industry and Location	If the work is traditionally performed by an employee under the direction of a supervisor, it is an indication of employment.	If the work is usually performed by an outside specialist or independent contractor, it is an indication of independence.

**Factor 3:** The skill required in performing the services and accomplishing the desired result.

Element	Employee	Independent Contractor
Required Level of Skill	<p>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.</p> <p>A high level of technical skill but integral to the business, it would be considered that the principal had the right to control the manner and means.</p>	<p>A high level of technical skill is important when combined with other factors such as owning a separate and distinct business.</p>

**Factor 4:** Whether the principal or the person providing the services supplies the instrumentalities, tools, and the place of work for the person doing the work.

Element	Employee	Independent Contractor
Work Done on Premises	<p>Doing the work on the principal's premises, or on a route, or at a location designated by a principal implies control, especially where the work is of such a nature that it could be done elsewhere (e.g. teleworker). The use of desk space and of phone and stenographic services provided by a principal, places the worker within the principal's direction 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, (for example employees of construction contractors), are necessarily performed away from the premises of the principal.</p>	<p>Doing work away from the principal's premises when it could be done on the principal's premises indicates a lack of control, especially when the work is free from supervision. This may be used with other factors to determine the worker is an independent contractor.</p>

Element	Employee	Independent Contractor
Tools and Materials	The furnishing of tools and materials by the principal when combined with other work characteristics may indicate control over the services provided. In some occupations, it is customary for individuals to provide small hand tools. In these cases, the fact that the particular worker provided these tools does not support independent contractor status.	When a worker furnishes tools and materials, especially when a substantial investment in the tools and materials is involved, there is an indication of independence.

**Factor 5:** The length of time for which the services are performed to determine whether the performance is an isolated event or continuous in nature.

Element	Employee	Independent Contractor
Continuing Relationship	The existence of a continuing relationship between a worker 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.	Typically, the relationship between an independent contractor and his or her client ends when the specific project is completed.

**Factor 6:** The method of payment, whether by the time, a piece rate, or by the job.

Element	Employee	Independent Contractor
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>	<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.</p>

**Factor 7:** Whether or not the work is part of the regular business of the principal, or whether the work is not within the regular business of the principal.

Element	Employee	Independent Contractor
Services Integral to the Principal's Business	<p>The services of the worker are a normal and essential part of the principal's business activities. The activities are central to delivering the services or product provided or produced by the principal.</p>	<p>The services of the worker are supportive of and not essential to the business activities of the principal.</p>

**Factor 8:** Whether or not the parties believe they are creating the relationship of employer and employee.

Element	Employee	Independent Contractor
Belief of Parties	<p>Although the belief of the parties is not controlling to any great extent, if both the worker and the principal believe that the relationship is employment or if either of the parties considers the relationship to be employment, this may be indicative of an employer-employee relationship.</p>	<p>Even though the parties may agree that the relationship is one of independence, it should be noted that the parties may not be aware of the rules or guidelines for determining a worker's status.</p>



**Factor 9:** The extent of actual control exercised by the principal over the manner and means of performing the services.

Element	Employee	Independent Contractor
Instructions	A worker that 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. A worker may perform services without receiving instructions because they are highly proficient and conscientious workers. Even if no instructions are given, the control factor is present if the principal has the right 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.
Training	Training of a worker by an experienced employee working with him or her; by required attendance at meetings, and by other methods, is a factor of control indicating that the principal wants the services performed in a particular manner. This is especially true if the training is given periodically or at frequent intervals.	An independent contractor ordinarily uses his or her own methods and receives no training from the purchaser of the services. He or she is not required to attend meetings
Integration	If the worker's services are so integrated into a principal'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 the assistants establish or affect his or her own business reputation and not the business reputation of those who purchase their services, it is an indication of an independent contractor relationship.

Element	Employee	Independent Contractor
Services Rendered Personally	If the services must be rendered personally, it indicates the principal is interested in the methods, as well as the results.	An individual's right to substitute another's services without the principal's knowledge suggests the existence of an independent relationship.
Set Hours of Work	The establishment of set hours of work by the principal 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.
Full-Time Work	Full-time work for the business is indicative of control by the principal 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. The 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.

Element	Employee	Independent Contractor
Order or Sequence Set	If a person must perform services in the order or sequence set by the principal, 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 principal. Often, because of the nature of the occupation, the principal either does not set the order of the services or sets them infrequently. Control is sufficiently shown, however, if the principal retains the right to do so.	If the principal 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.
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 constitute a review of his or her work. However, reports related only to an end result are not an indication of employment or independence.
Right to Fire	If a principal has the right to discharge an individual at will without liability, that worker is considered an employee. The principal exercises the control through the ever-present threat of dismissal, which causes the worker to obey instructions. A restriction on the principal's right to discharge a worker 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 or she produces a result that measures up to his or her contract specifications. However, the relationship can be terminated with incurring liability to either party.

Element	Employee	Independent Contractor
Right to Quit	The right to quit 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 a good faith attempt to complete the job. If the principal terminates an independent contractor on a contract job without cause, the principal is still liable to the independent contractor for the job.

**Factor 10:** Whether the principal is or is not engaged in a business enterprise or whether the services being performed are for the benefit or convenience of the principal as an individual.

Element	Employee	Independent Contractor
Whether or Not the Principal is in Business	It must be determined whether or not the services are performed for the principal as a businessperson or an individual. If the principal is in business that would be an indication that services performed by a worker for the principal are in employment.	If the services are performed for the principal as an individual, that could be indicative of the worker performing services as an independent contractor. An employment relationship is normally not established if the services performed are for the benefit or convenience of the principal as an individual. (See domestic services for possible employment by an individual.)

Another consideration relative to employment is whether or not the worker can make business decisions that would enable him or her to earn a profit or incur a financial loss. Investment of the worker's time is not sufficient to show a risk of loss.

### **3. Employment Status Determinations for Specific Industries for Periods Prior to January 1, 2020**

Sections 4304-2 through 4304-12 of Title 22, CCR, 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 the types of workers and industries listed below:

- Real Estate Salespeople (section 4304.2 of Title 22, CCR)
- Home Health Care (section 4304-3 of Title 22, CCR)
- Computer Services (section 4304-4 of Title 22, CCR)
- Artists (section 4304-5 of Title 22, CCR)
- Newspaper Distribution (section 4304-6 of Title 22, CCR)
- Product Demonstrators (section 4304-7 of Title 22, CCR)
- Security Dealers (section 4304-8 of Title 22, CCR)
- Language Interpreters (section 4304-9 of Title 22, CCR)
- Amateur Athletic Officials (section 4304-10 of Title 22, CCR)
- Process Servers (section 4304-11 of Title 22, CCR)
- Barbering and Cosmetology (section 4304-12 of Title 22, CCR)

### **4. Legal References**

The following form the basis for common law employment status determinations for the EDD:

- 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.

### **D. Case Analysis**

The following steps should be taken, as necessary, when analyzing a case and making an employment status determination:

- Gather all relevant facts.
- Document the reason the principal considered the worker(s) to be (an) independent contractor(s).
- Secure documents that describe the relationship.
- Identify and review the legal issues and appropriate court cases.
- Identify and review the primary and secondary common law factors to determine the existence of the right of direction and control.
- Apply the law to the facts in each case.

**E. Application of Statutory Employment Rules**

**1. Introduction**

Certain classifications of services have been included in the CUIC as statutory employment. These select classes of workers are generally covered by the CUIC for UI, ETT, and SDI purposes. Personal Income Tax withholding is not required if a statutory worker such as an agent-driver or commission-driver, a traveling or city salesperson, a homemaker, an artist, or author does not also meet the criteria for subject employment. Personal Income Tax (PIT) withholding is required for specific statutory employees including corporate officers, workers in the construction industry, or members of a limited liability company (LLC) treated as a corporation for federal income tax purposes.

**2. Statutory Employees**

A statutory employee is defined as an employee by law under a specific statute of the CUIC. These groups of employees should be identified and the corresponding code sections applicable to the specific statutory employees addressed. Specific classes of statutory employee include:

	UI - ETT - DI	PIT
Corporate Officers	Section 621(a)	Section 13004
Agent or Commissioned Driver	Section 621(c)(1)(A)	
Traveling or City Salesman	Section 621(c)(1)(B)	
Homeworkers	Section 621(c)(1)(C)	
Artists and Authors	Sections 601.5 and 621(d)	
Work Made for Hire	Sections 621(d) and 686	
Unlicensed Construction Workers	Section 621.5	Section 13004.5
Any Member of an LLC treated as corporation for federal income tax purposes	Section 621(f)	Section 13009

**F. Employer Determinations - Multiple Entities**

**1. Introduction**

Determining the correct employer of a worker is a two-part process. First, the worker must be a subject employee. If the worker is determined to be a subject employee, then the employer for purposes of state payroll tax reporting must be identified. When multiple entities are involved in an employment relationship, sections 606 and 606.5 of the CUIC are applied to determine the correct employer in the following instances:

- Employees/helpers of workers found to be employees
- Temporary services agencies and employee leasing agencies
- Agent of the employer
- Loan of an employee from one employer to another employer

## **2. Employees/Helpers of Workers Found to be Employees**

Under section 606 of the CUIC, if an employing unit has actual or constructive knowledge of an employee/helper of a worker determined to be an employee of that employing unit, whether or not the employing unit hired or paid the employee/helper, the employing unit is the correct employer of the employee/helper.

Pursuant to section 606-1(a) of Title 22, CCR, *constructive knowledge* by an employing unit of the work of each individual employed to perform or to assist in performing the work of any employee of that employing unit, whether or not the individual was hired or paid directly by the employing unit, exists under any of the following circumstances:

- (1) The extent of the territory to be covered, or the amount of work to be done is such that the work of the employee cannot be performed without the assistance of another individual.
- (2) The nature of the business is such that the employment of an assistant or substitute individual will be required to perform or to assist in performing the work of the employee.
- (3) The amount or the method of computation of the compensation indicates that the remuneration is in excess of that normally expected to be paid solely to one employee for the performance of the work.
- (4) The employment of an assistant or substitute individual in the particular work involved is a customary practice, or is required by a union agreement or the contract of employment.
- (5) The employing unit has given the employee general authority to take such action as in his judgment is required for performance of the work.

## **3. Temporary Services Agencies and Employee Leasing Agencies**

A temporary services employer and an employee leasing employer are employing units that contract with clients or customers to supply workers to perform services for the client or customer and perform all of the following functions in section 606.5(b) of the CUIC:

- (1) Negotiates with clients or customers for matters such as time, place, type of work, working conditions, quality, and price of the services.
- (2) Determines assignments or reassignment of workers, even though workers retain the right to refuse specific assignments.
- (3) Retains the authority to assign or reassign a worker to other clients or customers when a worker is determined unacceptable by a specific client or customer.

- (4) Assigns or reassigns the worker to perform services for a client or customer.
- (5) Sets the rate of pay of the worker, whether or not through negotiation.
- (6) Pays the worker from its own account or accounts.
- (7) Retains the right to hire and terminate workers.

If an individual or entity contracts to supply workers to perform services for a customer or client and all of the above seven functions are met, pursuant to section 606.5(c) of the CUIC, the individual or entity is the correct employer of the workers who perform the services.

#### **4. Agent of the Employer**

If an individual or entity contracts to supply an employee to perform services for a client or customer and the seven functions above are not met, the individual or entity is not a leasing employer or a temporary services employer. Pursuant to section 606.5(c) of the CUIC, the individual or entity is the correct employer and pays the wages as the agent of the client or customer.

#### **5. Loan of an Employee from One Employer to Another Employer**

In circumstances where an employee is loaned by one employer to another employer, the loaning employer remains the employer responsible for payroll tax reporting purposes if the loaning employer continues to pay remuneration to the employee, whether or not reimbursed by the other employer. However, if the employer to whom the employee is loaned pays remuneration directly to the employee for services performed, that employer shall be considered the responsible employer for employment tax purposes for any remuneration paid to the employee by such employer. This is true regardless of whether the loaning employer also pays remuneration to the employee. Refer to section 606.5(d) of the CUIC.



## Tax Audit Guidelines

### Chapter X

#### Personal Income Tax Assessment and Adjustment

##### A. Overview

###### 1. Introduction

Section 13020 of the California Unemployment Insurance Code (CUIC) requires an employer paying wages to California resident employees for services performed within or without California, or to non-California resident employees performing services in California, to withhold Personal Income Tax (PIT).

Section 13021 of the CUIC requires every employer to file a withholding report and remit the PIT withheld. Section 13070 of the CUIC establishes that the employer shall be liable for the payment of the PIT required to be deducted and withheld. If PIT is not properly deducted and withheld, an assessment will be issued under section 1126 of the CUIC and/or section 1127 of the CUIC.

Section 13071 of the CUIC states that if an employer fails to withhold Personal Income Tax (PIT) from employee wages and the wages were reported on the employee's state income tax return, the taxes will not be collected from the employer. This is referred to as the PIT abatement process. This section further provides that the employer will not be relieved of any penalties or additions otherwise applicable for failure to deduct and withhold.

It is the employer's responsibility to engage in the PIT abatement process. During a tax audit, the assigned auditor will explain the PIT abatement process to the employer and provide the employer with a copy of the *Information Sheet: Personal Income Tax Adjustment Process* (DE 231W).

###### 2. Assessment of Personal Income Tax (PIT) Liability

A PIT assessment can be made when:

- The employer fails to properly report PIT withheld, or
- The employer fails to properly withhold PIT.

In both cases, PIT will be assessed and all applicable penalties and interest included. The assessment may include both types of PIT assessment. However, the employer can utilize the PIT abatement process when the assessment is for PIT that was not withheld from an employee's wages.

### 3. Two Separate Types of Relief

PIT abatement provided by section 13071 of the CUIIC is considered the adjustment of the PIT assessed. PIT abatement provides no relief from penalties and only partial relief from the interest attributed to the PIT assessed. Partial relief of interest is recalculated as follows:

- For the period after the worker paid the taxes to the Franchise Tax Board (FTB) based on their quarterly estimated payment dates to the issue date of the assessment.
- For the period after the date the workers filed their income tax return with payment in full, or the date the income tax return is due after April 15 of the following year to the issue date of the assessment.

The tax adjustment provided by section 1136 of the CUIIC allows for an adjustment and cancellation of the tax, penalties, and interest associated with the tax. Adjustments pursuant to section 1136 of the CUIIC are provided in the following examples:

- When the employer recalculates the PIT.
- When additional information discloses that a worker previously determined to be an employee is actually an independent contractor.
- When payments originally determined to be wages are actually not wages.

### 4. Forms Used to Make Adjustments

Employers may seek relief from paying the PIT assessed in the following ways:

- The *Declaration* (DE 6028P) is used when the employer has issued the Internal Revenue Service (IRS) *Miscellaneous Income* (Form(s) 1099-MISC), *Wage and Tax Statement* (Form(s) W-2) and/or Schedule(s) K-1 to the worker(s). The employer signs the DE 6028P to declare that the forms were filed timely with the IRS and/or FTB. If the employer properly completes and signs the DE 6028P and the auditor has processed any needed verification, the PIT will be abated for all workers issued Form(s) 1099, Form(s) W-2, and/or Schedule(s) K-1. The DE 6028P applies to audits completed after July 1, 2008.
- The *Claim for Adjustment or Refund of Personal Income Tax* (DE 938P) is used when an employee certifies that the income tax liability has been paid by filing a California Personal Income tax return or that an adjustment of the liability based on quarterly estimated tax payments has been made. The employer may contact the worker(s) to obtain their signature(s). If the DE 938P is returned and properly completed, the PIT adjustment will be processed.

The DE 938P form(s) will be provided to the employer for completion under the following situations:

- The auditor did not accept the completed DE 6028P because the auditor cannot verify that the Form(s) 1099-Misc, Form(s) W-2, and/or Schedule(s) K-1 were issued or filed.
- Workers were issued Form(s) 1099-Misc, Form(s) W-2, and/or Schedule(s) K-1 with no SSN or recipient identification number.
- The employer chooses not to complete and sign the DE 6028P.

#### **5. Quarterly Estimates and Automatic Applications for Extension**

The requirements of section 13071 of the CUIIC are satisfied if the employee's PIT is paid to the FTB by quarterly estimates, based on income which includes assessed wages. The *Payment for Automatic Extension for Individuals* (Form FTB 3519) serves the same purpose as quarterly estimates since it is a payment of the tax due. If an employee has submitted a tax payment with the Form FTB 3519 based on the wages in question, the PIT will generally be adjusted.

#### **6. Bankruptcy**

When the employer is bankrupt or in bankruptcy, the DE 938P form(s) will be provided to the employer according to the procedures contained in this chapter.

#### **7. PIT Adjustment Not Applicable**

The following are some situations when PIT will be assessed, but no adjustment of the assessed liability will be granted:

- Quarterly audited PIT withheld exceeds PIT reported.
- Total PIT from Form(s) W-2 exceeds total PIT reported.
- When it is necessary to make an estimate. The PIT liability is not adjusted on estimated wages unless the workers are identified and it is verified that no PIT was withheld.
- When it is known that the employer withheld but did not report all or part of the tax and the employer is unable to produce records adequate to determine the correct amount withheld.

#### **8. Last Completed Calendar Year Wages**

For the last completed calendar year wages on cases completed January 1 through April 15 of the subsequent year, the employer will be offered the option of using the DE 938P or the DE 6028P to process the adjustment. After the employer makes an election, the proper forms will be provided to the employer.

If the employer chooses to use the DE 6028P to seek relief from paying the PIT assessed, the PIT abatement process will not be completed until after April 15 of the following year. This process allows the auditor to verify that the corresponding forms were filed with the IRS and/or FTB.

## Chapter X

If the employer chooses to use the DE 6028P to seek relief from paying the PIT assessed, the PIT abatement process will be completed at any time if the employee made estimated tax payments. Otherwise, the adjustment will not be completed until after April 15 of the next calendar year because that is the date the employee can first attest that the payments were reported on his or her California state income tax return.

### 9. Recalculation of PIT

Occasionally, the PIT calculation method needs to be changed after the audit or investigation is completed. If the employer wishes to recalculate the assessed PIT, the DE 938P, Item 4, must be completed. For the employer to recalculate PIT, a calculation worksheet must be provided.

- If there was a completed *Employee's Withholding Allowance Certificate* (Form W-4 or DE 4) on file at the time the wages were paid, it must be used as a basis for computing the taxes that should have been withheld. Otherwise, the employer must use the single with no deductions (S-0) rate to compute the taxes that should have been withheld.
- The tax for each pay period should be computed using the *California Employer's Guide* (DE 44) for the correct year. It is necessary to identify the frequency of the pay period in order to use the schedules. If the payments are sporadic, it may be necessary for the employer to use the daily/misc. schedules.
- The aggregate tax for all pay periods should be added for each quarter and the totals entered in the appropriate box on the DE 938P form.
- The employer must sign and date the DE 938P. The worksheets prepared by the employer to recalculate the tax must be attached to the DE 938P.

### 10. Time Requirements

There is no time limitation for returning the DE 938P and DE 6028P forms when the liability has not been paid. If the liability has been paid, the statutory time limits under the provisions of section 1178 of the CUIIC are applicable.

Section 1178 of the CUIIC provides that a claim for refund or credit may be filed:

- Within three years from the last day of the calendar month following the close of the calendar quarter for which the overpayment was made, or
- Within six months after the assessment became final, or
- Within 60 days from the date of overpayment.

### 11. Denial of Claim for Refund

If the DE 938P and/or DE 6028P PIT abatement process is not available and the assessment is paid, a written denial of a claim for refund may be made. If the EDD does not respond within 60 days to the written claim for refund the person or employing unit that filed the request may consider the claim denied and file a petition with an Administrative Law Judge (ALJ) of the California Unemployment Insurance Appeals Board (CUIAB).

## Tax Audit Guidelines

### Chapter XI

#### Penalty Determination/Application

##### **A. Penalties - Overview**

The 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. Employers should be aware that failure to comply may generate a penalty.

##### **B. Penalty Determination - Sections 1112(a) and 1112(b) of the 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 15 percent of the amount of those contributions." This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

Section 1112(b) provides: "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 15 percent of the amount of those contributions." This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

Since sections 1112(a) and 1112(b) of the CUIC are penalties under article 7, CUIC, there are no appeal rights unless the penalty is paid and a claim for refund is made and denied.

Please see *Information Sheet: Waiver of Penalty Policy* (DE 231J) for specific information about how to determine if you have good cause. In addition, *Information Sheet: Penalty Reference Chart* (DE 231EP) provides a complete listing of all penalties.

##### **1. Upon Closing Business**

Section 1116 provides 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 the EDD.

A penalty will be charged pursuant to section 1112(a) when contributions due on a 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, a penalty pursuant to section 1112(a) will be charged.

## **2. Consolidated Return**

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

### **Example:**

*A Quarterly Contribution Return and Report of Wages (DE 9), Quarterly Contribution Return and Report of Wages (Continuation) (DE 9C), and Payroll Tax Deposit (DE 88ALL) are filed and paid in January and are identified for the fourth quarter of the prior year. The returns also contain wage information for the third quarter of the prior year. The returns 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, the section 1112(a) penalty will accrue on the normal delinquency date of the third quarter.*

## **3. Supplemental Returns**

If amended or supplemental returns are secured along with partially paid, fully paid, or unpaid and signed DE 88ALLs, the EDD Accounting and Compliance Enterprise System (ACES) DE 88ALL(s) and/or signed DE 9, the EDD will bill the employer for additional contributions due and charge any applicable section 1112 penalties.

## **4. Hybrid Assessment**

If a *hybrid* assessment is levied pursuant to section 1127 for a quarter which is due but not yet delinquent, the section 1112 penalty is not charged. The penalty pursuant to section 1112 will begin to accrue on the normal delinquency date of the quarter. The penalty provisions of sections 1126, 1127, 1128, and 1135 will not apply.

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

## **C. Penalty Determination - Section 1112.5 of the CUIC**

### **1. Overview**

A 15 percent penalty pursuant to section 1112.5 shall be added to the amount of contributions due when an employer has not filed a required return within 60 days of the delinquency date for the quarter. This will be in addition to penalties pursuant to sections 1112, 1114, 1126, 1127, and 1128. This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

The 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 pursuant to section 1111. Employers should be informed that when extensions are granted, this penalty will apply if the returns are filed more than 60 days after the original delinquency date of the quarter.

Since the penalty pursuant to section 1112.5 is a penalty under article 7 of the CUIIC, 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 (PIT) due, and in cases where an assessment was issued and appealed, the penalty would be reduced proportionately for any part of the assessment which is reduced.

## **2. When the Penalty Applies**

The section 1112.5 penalty will apply when:

- The DE 9 or DE 9C is filed more than 60 days after the final filing date of the quarter.
- An assessment is issued where no return has been filed and it is more than 60 days delinquent.
- An assessment is issued where the return was filed, but it was more than 60 days delinquent when it was filed.
- In cases where an audit or investigation reveals a previously nonregistered employer failed to file for quarters that are more than 60 days delinquent.

## **3. When the Penalty Does Not Apply**

The section 1112.5 penalty shall not apply:

- When it is determined that the employer had *good cause* for not reporting timely.
- To any contributions which were paid on or before the prescribed payment dates pursuant to section 1112.5(b).
- In cases where an assessment is issued prior to the date on which the penalty would apply. For example, an assessment issued on the basis of an unpaid, unsigned return, or an assessment issued from an audit before the 60 days have elapsed.
- When *no-payroll* returns are filed, unless the returns are filed more than 60 days late, the returns are found to be deficient, and there is no good cause.

#### **4. Cancellation of the Section 1112.5 Penalty**

The EDD's ACES will charge the 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.

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

#### **D. Penalty Determination - Section 1114 of the CUIC**

Section 1114(a) authorizes wage item penalty (WIP) charged to any employer who fails to file a report of wages within 15 days after the EDD has made a specific written demand to the employer, unless it has been determined that good cause exists.

This penalty is charged in addition to other penalties charged and is computed at the rate of \$20 for each unreported wage item or for each reported wage item that is received later than 15 days after specific written demand has been served or mailed. This penalty is applied at the rate of \$10 per unreported wage item for periods prior to the third quarter of 2014.

##### **1. Number of Wage Items**

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

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

##### **2. Specific Written Demand**

A specific written demand is one of the following:

- *Notice of Form Delinquency* (DE 6694) containing a written demand.
- A letter which contains a specific written demand for quarterly wage information. The demand may be issued by the Area Audit Program Manager.

##### **3. Good Cause**

The auditor will determine whether good cause for waiver of the WIP 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 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 section 6707 of the Government Code.
3	<p>If the demand is issued by mail, section 1013 of the Code of Civil Procedure (CCP) extends the last timely date as follows:</p> <ul style="list-style-type: none"> <li>• Five days if the place of business is in California.</li> <li>• Ten days if the place of business is outside of California but within the United States.</li> <li>• Twenty days if the place of business is outside the United States.</li> </ul>
4	If step 3 ends on a Saturday, Sunday, or holiday, extend to include the next business day pursuant to section 6707 of the Government Code.

**Example:**

On Friday, February 26, the 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 wage items. To determine the last timely date for the employer to file the wage report, add 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 five days pursuant to section 1013 of the 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 the penalty would apply.

If the report of wages was filed on or after Tuesday, March 23, the penalty charge would be WIP of \$40.00 (two wage items x \$20 = \$40).

**Note:** The auditor will determine whether good cause exists for waiver of the penalty.

## **E. Other Penalty Applications - Section 1114 of the CUIC**

### **1. No Payroll Report Filed**

Filing a *no-payroll* return in response to a demand for a delinquent quarter is sufficient to clear a return delinquency. However, if subject wages are subsequently reported in an amended return or are discovered by the EDD 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 wage items are discovered.

### **2. Estimated Assessment**

If a report of wages is filed and is determined to be correct, or the EDD 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 employer payroll tax 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 pursuant to section 1114 issued on one account constitute a demand for the other account.

### **4. Wages Legally Due but Unpaid**

A penalty pursuant to 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 section 1088-3 of Title 22, California Code of Regulations (CCR), and the 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 (section 926-1 of Title 22, CCR) and wages legally due but unpaid (section 1088-3 of Title 22, CCR), 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 the penalty pursuant to section 1114(a) will be charged unless good cause is found. In such case, the section 1114(a) penalty will be charged only on that portion of the report required by section 1088-3 of Title 22, CCR.

## **5. Self-Coverage**

WIP does not apply to elective coverage provisions pursuant to sections 708 or 708.5 of the CUIC.

## **F. Non-Compliance Penalty**

Employers who are required by the federal government pursuant to section 6011 of the Internal Revenue Code (IRC) to report electronically are also required by California law to file wage and withholding data electronically.

Section 1114(b) authorizes wage item penalty and interest when an employer fails to file their report of wages electronically, after being notified by the EDD of their mandatory electronic filing status, unless it has been determined a good cause exists.

Any mandatory electronic filer who, without good cause, fails to file their report of wages electronically, will be assessed a penalty of \$20 (\$10 for periods prior to the third quarter of 2014) for each wage item reported on a paper wage report, pursuant to section 1114(b) of the CUIC.

The e-file and e-pay mandate (AB 1245) requires all employers to electronically submit their employment tax returns, wage reports, and payroll tax deposits as of January 1, 2018. Penalties for non-compliance with the e-file and e-pay mandate will be charged effective January 1, 2019, as provided in sections 1112(c) and 1114(c) of the CUIC.

## **G. Penalty Determination - Section 1117 of the CUIC**

Section 1117 provides that if any employer fails, without good cause, to file an *Annual Reconciliation Statement* (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 unemployment insurance (UI), employment training tax (ETT), disability insurance (DI), and personal income tax (PIT), whichever is less. Note: the requirement to file form DE 7 does not apply to the 2012 calendar year and thereafter.

## **H. Penalty Determination - Sections 1126, 1126.1, and 1127 of the CUIC**

### **1. Section 1126 Description**

When an employing unit fails to file a return, a penalty of 15 percent of the contributions payable is mandatory pursuant to section 1126. The CUIC contains no provisions for the waiver of this penalty. This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

### **2. Section 1126.1 Description**

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

This penalty is applied only in conjunction with 1126 assessments. If the failure to register was due to negligence, this penalty is not applicable. This one-time penalty is applied in a quarter where a section 1126 assessment is being issued. This penalty may **not** be applied in any quarter where there is a section 1127 assessment.

### **3. Section 1127 Description**

Pursuant to section 1127, when the Director is not satisfied with the return made by an employing unit, the EDD may make an assessment for the additional amount due. If the return or report was deficient due to negligence or intentional disregard, a penalty of 15 percent of the amount of deficiency will be added to the assessment. This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

### **4. Application of the Section 1127 Penalty**

- Each quarter must be considered separately when applying the penalty pursuant to section 1127.
- The penalty pursuant to 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**

Section 1127-1(a) of Title 22, CCR 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**

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

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

### **I. Penalty Determination - Sections 1128(a) AND 1128(b) of the CUIC**

Pursuant to 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 sections 1126 and 1127.

Section 1128(b) provides that an additional 50 percent penalty (in addition to the section 1128[a] penalty) will be added if the employer paid wages and failed to provide information returns as required pursuant to section 13050 of the CUIC or section 6041A of the Internal Revenue Code (IRC). This penalty shall be in addition to any penalties pursuant to sections 1126, 1127, 1128(a), 13052, or 13052.5.

The section 1128 penalty may be charged on assessments levied pursuant to section 1137. It can also be included in section 1735 assessments, if the penalty was originally assessed against the employing unit. Each quarter must be considered separately in applying penalty pursuant to section 1128 of the CUIC.

### **J. Section 1128.1 of the CUIC**

Section 1128.1 authorizes the 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 - Section 1135 of the CUIC**

#### **1. Description**

Pursuant to section 1135, if an employing unit fails to pay an assessment in full on or before the date the assessment becomes final, a penalty of 15 percent of the delinquent contributions will be added (unless a timely petition was filed). The addition of the section 1135 penalty is mandatory. There are no provisions for the waiver of this penalty. This penalty is applied at the rate of 10 percent for periods prior to the third quarter of 2014.

## **2. Jeopardy Assessment**

When a jeopardy assessment is levied pursuant to section 1137 of the CUIC, a penalty pursuant to section 1135 is applicable. Pursuant to section 1221, an assessment levied pursuant to section 1137 is immediately final. The 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 - Section 1142 of the CUIC**

If the 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 section 1142 penalty will be charged. The penalty will be charged against an employer of the claimant in an amount not less than two or more than ten times the claimant's weekly benefit amount.

### **M. Section 13052 of the CUIC**

Section 13052 allows a penalty to be assessed against an employer who:

- Fails to furnish an employee with a federal Form W-2 on or before January 31 of the year following the year the payments were made and showing the information required pursuant to section 13050 of the CUIC.
- Provides a false or fraudulent federal Form W-2.

Section 13052 provides that a penalty of fifty dollars (\$50) for each such failure will be charged, unless reasonable cause is found.

### **N. Section 13052.5 of the CUIC**

In addition to the penalty imposed by section 13052, if any person or entity fails to report amounts paid as remuneration for personal services as required under section 13050 of this code or section 6041A of the IRC on the date prescribed thereof, determined with regard to any extension of time for filing, that person or entity may be liable for a penalty charged at the maximum rate under section 17041 of the Revenue and Taxation Code multiplied by the unreported amounts paid as remuneration for personal services.

This penalty may be assessed in lieu of, or in addition to, the penalty imposed by section 13052 with respect to the failure to furnish a withholding statement to an employee.

This penalty only applies to workers determined to be subject employees and will not be applied to current year assessment periods.

## Chapter XI

There are no administrative remedies applicable to section 13052.5 penalty assessments. Once an assessment is issued, this penalty cannot be reduced for workers later determined to be bona fide independent contractors. However it may be reduced for payments determined to be not for services.

Beginning January 1, 2018, this penalty will have petition rights.

### **O. Penalties Covering Elective Coverage**

#### **1. Elective Coverage**

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

## Tax Audit Guidelines

### Chapter XII

#### Completing an Audit

#### **A. Closing Interview**

##### **1. Purpose**

The audit/investigation findings entered on the working papers and supporting documents will be discussed with the employer and/or the authorized representative\* to:

- Identify any undisclosed facts and resolve disputed points.
- Review the *Proposed Notice of Assessment (PNA)* (DE 6517P), if applicable.
- Fully explain all proposed adjustments, if applicable.
- Attempt to obtain concurrence.
- Provide information regarding petition rights, if applicable.
- Secure payment or discuss payment options, if applicable.
- Educate and provide resources for future use; the Information Sheet Series, DE 231, if applicable.

\*The authorized representative must be designated by a *Power of Attorney (POA) Declaration* (DE 48) on file with the EDD.

##### **2. Proposed Notice of Assessment or Credit (PNA)**

If the audit results in an assessment, the auditor will provide the PNA to the employer or the authorized representative in person, by fax, or mail. The purpose of the PNA is to discuss the audit findings, advise the employer of the amount due, and to request payment of the resulting liability. If the adjustments are all credits, the PNA will be provided at the employer's request.

##### **3. Advising the Employer**

The auditor will discuss all findings, any payroll errors made, and any status determinations made during the audit period with the employer. The auditor will advise and provide the employer with information on the proper method of reporting payments for personal services. The auditor will inform the employer that the EDD and the Internal Revenue Service (IRS) have an information exchange agreement and the audit file may be made available to the IRS.

- Discuss the misclassified workers and/or payments and why they were determined to be employees and/or wages. Provide the applicable code sections and how subject wages were calculated.



- Explain the various elements of the PNA including how the liability for each tax, penalty, and interest is calculated.
- Identify any liability that does not have petition rights (e.g., section 13052.5 penalty charged on assessments issued prior to January 1, 2018).
- Explain the Personal Income Tax (PIT) abatement process and the amount of PIT that can be abated. Explain how interest and penalty is calculated on PIT after it has been abated.
- Explain the finality date of the assessment and potential penalty of not paying the assessment or filing a petition prior to the finality date.
- Request payment of the assessment and provide information on the EDD programs for re-payment, including but not limited to, installment agreements.
- Advise the employer about state tax lien information, if applicable.
- Advise the employer of the right to petition which will be included in the *Notice of Assessment (NOA)* (DE 6517).

The employer will be sent the *Notification of Audit Results and Right to Review Audit File* (DE 105) informing the employer of the right to inspect the file.

#### **4. Non-Concurrence Noted**

Any disagreement (or non-concurrence) by the employer will be identified and explained in the *Audit Report* (DE 6580). A note in the audit report will be included if the employer notifies the auditor that it intends to file a petition.

#### **5. Who to Interview**

- Any discrepancies or issues of non-compliance must be discussed with the employer who has authority to make changes in the organization's reporting procedures.
- If the audit resulted in the employer owing additional tax, the auditor will contact a person authorized to make payment for the business being audited and attempt to obtain payment of all contributions found to be due as a result of the audit.
- A properly conducted closing interview may avoid future misunderstandings and alleviate the need for a pre-assessment and/or post-assessment conference, petition for re-assessment, and/or tax hearing.
- The employer's representative designated on the *Inquiry Regarding Records* (DE 996) is not necessarily the appropriate individual for the closing interview.
- The employer's authorized representative may be present with the employer during the discussion upon the employer's request.
- When the auditor is unable to contact the appropriate individual to discuss the audit/investigation findings and attempt to secure payment of the resulting liability, the auditor will send a letter offering to meet and discuss the case with the individual.

## **B. Pre-Assessment and Post Assessment Conferences**

### **1. Objective of the Pre-Assessment and Post-Assessment Conference**

The objective of a pre- or post-assessment conference is to:

- Meet with the auditor's supervisor to discuss the audit findings.
- Provide an opportunity for the employer to present additional information that was not available during the audit.

### **2. Pre-Assessment Conference**

A pre-assessment conference will be offered to the employer whenever the audit results in an assessment or there has been a denial of claim for refund. If the employer accepts the offer of a conference, the auditor will arrange an agreeable time for the employer and/or the authorized representative and the auditor's supervisor (conference leader) to meet and discuss the audit findings. If the employer and/or the authorized representative still do not concur with the findings after the pre- or post-assessment conference, the auditor or the auditor's supervisor will provide information regarding the petition rights.

### **3. Post-Assessment Conference**

A post-assessment conference will be offered to the employer if:

- The employer has not previously participated in a pre-assessment conference.
- The employer initially concurred with the audit findings and subsequently disagrees with the assessment, files a petition for reassessment, or a claim for refund.
- The employer elects a post-assessment conference in lieu of a pre-assessment conference.
- The employer has additional information or documentation to support its position after attending the pre-assessment conference.

### **4. Conference Leader's Responsibilities**

The conference leader's responsibilities when conducting an assessment conference are to:

- Provide the employing unit with a fair and courteous opportunity to present its position.
- Assure all pertinent facts are included in the audit report and are considered.
- Assure any tax adjustment is in accordance with the CUIIC and applicable regulations.
- Explain the conclusions reached and the reasons.

## 5. Conference Report

A conference report will be prepared after each conference. The report will include the date of the conference, the names and titles of the persons present, and a summary of additional facts obtained and/or conclusions reached with respect to each issue.

## 6. Conference Not Held

If a conference was not held (e.g., employer refused the offer, employer failed to attend, etc.), the reasons must be explained in the *Audit Report* (DE 6580).

# C. Case File Access and Inspection of Employer Records

## 1. Inspection of Employer Information

An employer may request to review the closed audit or investigative file in order to properly prepare for a post-assessment conference, to decide whether to file a petition, and/or to prepare and file a petition with the California Unemployment Insurance Appeals Board.

An audit or investigation is considered closed when the *Notice of Assessment* (DE 6517) or the *Notification of Audit Results and Right to Review Audit File* (DE 105) has been mailed to the employer.

All requests to review case files are reviewed by the office manager or his/her designee to ensure that information not disclosable to the employer has been redacted.

## 2. Copying Costs

- **No Charge:** Sections 1095(b), (c), (d), and (e) of the CUIIC require the EDD to provide specified information about their account to an employer, claimant, and/or authorized representative at no charge. Employers, claimants, and/or authorized representatives requesting copies of any records maintained for their account, will be provided copies at no charge.
- **May Be Subject to Charges:** Sections 1095(f) to (z) of the CUIIC specify governmental entities, law enforcement agencies, and others that may obtain EDD information (via established protocols) may be required to pay for copies.

If the requester wishes any part of the file to be reproduced, a fee of \$0.10 per page will be assessed. Fees are waived up to \$2.00.

### **3. Denial of Right to Inspect**

If a request for disclosure of information is denied, the Area Audit Program Manager (AAPM) or designated staff person must provide a brief written statement on the *Information Collection and Access Form* (DE 8445A) setting forth:

- The reason for denial.
- The right of the requester to seek review of the denial, including the name, office number, and title of the official to whom a request for review is to be directed.

### **4. Appeal of Denial of Right to Inspect**

If the requestor requests a review (appeal) of the DE 8845A prepared by the AAPM or designated staff person, instruct the requester to provide a copy of the DE 8845A. The requester should submit the written appeal to:

Employment Development Department  
Attention: Information Security Officer  
Information Technology Branch, MIC 33  
PO Box 826880  
Sacramento, CA 94280

The Information Security Officer (ISO) will review the appeal and accompanying documents. The ISO will make a recommendation to the Director for response within 30 days from the date the appeal is filed. An appeal will be deemed *filed* on the date it is postmarked.

The ISO will send written notification of the final decision to the requester and a copy of the decision to the AAPM or designated staff person who made the initial determination.

## Tax Audit Guidelines

### Chapter XIII

#### Audit/Investigation Report

#### **A. Overview**

##### **1. Purpose**

The auditor's audit/investigation is documented on an audit/investigation report for every completed audit/investigation. The audit/investigation report is conducted within the EDD's accounting system and the audit/investigation findings are documented on the *Audit Report* (DE 6580).

##### **2. Audit/Investigation Report**

The DE 6580 has been designed for use in all audits/investigations. The DE 6580 includes the following:

- The employer's compliance with the EDD's reporting requirements.
- Audit exceptions.
- Potential complaints or problems.
- Audit findings.
- Employer was advised of the 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.

The following are the sections included in the DE 6580:

- Entity Examination
- Misclassified Workers
- Audit Detail Narrative
- Scope of Audit
- Audit Differences
- Penalties
- Post-Audit Discussion
- Financial Data
- Payroll Test Narrative

Tax Audit Guidelines

Chapter XIV

Ruling Letters

**A. Ruling Letters - Overview**

**1. General**

A ruling is a written determination issued to an employer or potential employer which interprets and applies the California Unemployment Insurance Code (CUIC) to a situation discovered during an audit or investigation. Ruling letters are written to ensure uniform and consistent application of the law.

**2. When a Ruling Letter May Be Issued**

A written ruling may be issued in the following situations:

- An employer requests a written ruling.
- The employer does not concur with the 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.
- The EDD determines that a horizontal unity of enterprise exists.

**B. Ruling Letters - Content**

**1. Elements of a Ruling Letter**

Ruling letters will contain the elements listed below:

<b>Element</b>	<b>Description</b>
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 the subject matter to be discussed in the remainder of the letter.

Element	Description
Body of Letter	<ul style="list-style-type: none"> <li>• One or more paragraphs will be used to describe the:               <ul style="list-style-type: none"> <li>• Nature of the business</li> <li>• Services reported by the employing unit</li> <li>• Services and/or individuals not reported</li> </ul> </li> <li>• 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"> <li>• Include facts that support both the EDD's position and the employer's position.</li> <li>• Conclusions are not to be substituted for facts in the ruling letter.</li> </ul> </li> <li>• The author will not rely on other rulings for the statement of facts. No two cases are identical.</li> </ul>
Statement of Law	<p>One or more paragraphs will be used to identify the applicable provisions of the law. Sections of the CUIC 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 section 135.2 of the CUIC and 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 explain how the facts of the case relate to the regulation.</p>
Administrative Remedies	<p>The ruling letter will contain a statement regarding the employing unit's administrative remedies, if applicable. This paragraph should also reference the appropriate form(s) for the employer's petition rights and/or informational purposes.</p>
Person to Contact	<p>A final paragraph may be added to provide the name and phone number of the office manager. If the employer has any questions regarding the audit or investigation, or requires an explanation of the ruling letter, the manager familiar with the case will best be able to provide an explanation.</p>

## **2. Other Required Information**

All ruling letters will also contain the following specific information:

- Letter ID, Issuance Date, and Case ID shown in the upper right corner.
- Name and address of the employer.
- Name and phone number of author.
- Electronic signature of the Office Manager.



## Tax Audit Guidelines

### Chapter XV

#### Notices of Assessment

#### A. Overview

##### 1. Introduction

The Employment Development Department (EDD) Notice of Assessment is defined as a notice to an employer or individual for taxes and/or penalties owing under provisions of the California Unemployment Insurance Code (CUIC), commencing with section 1126 of chapter 4, article 8.

##### 2. Basic Requirements

EDD Assessments:

- Are in writing.
- State in the body thereof that it is a Notice of Assessment.
- Identify the employing unit to which it refers.
- Identify the period to which the assessment relates.
- Explain the basis for the assessment and state the sections of the CUIC pursuant to which the assessment is issued.
- Show the amount of contribution and tax assessed, and penalty and interest charged.

A written notice is required under section 1131 of the CUIC and must be issued in accordance with section 1206 of the CUIC.

##### 3. Notice to Employer

Currently, the EDD issues the *Employer Account Statement* (DE 2176) and the *Notice of Assessment* (DE 6517) through our accounting system.

Prior to ACES, if a *Notice of Assessment – Personal Computer* (DE 107PC) was used, the accounts receivable liability was manually established in the EDD's Tax Accounting System (TAS). The DE 107PC was an official assessment manually prepared in situations such as unity of enterprise, out-of-business partnerships, successor, responsible person, jeopardy, or when the statutory limitation on any period was near expiration.

**B. Assessment Criteria Pursuant to Sections 1126 and 1127 of the CUIC**

The EDD will assess an employer pursuant to section 1126 of the CUIC when no return (DE 9, DE 3HW, DE 3D, or DE 3DI) is filed with respect to a calendar quarter for which contributions were due and are delinquent.

Pursuant to section 1127 of the CUIC, if the Director is not satisfied with any return made by an employing unit, an assessment will be levied for additional amounts due. 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 - Section 1132 of the CUIC**

**1. Introduction**

The time limitations for making assessments are contained in section 1132 of the CUIC. The EDD must issue an assessment for a quarter or the entire audit period within statutory time limits. The statutory time limits may be extended using the *Extension of Time for Making Assessments and a Claim for Refund or Credit*, DE1977. Section 1132 allows an employer to waive the statutory limit or consent to its extension.

**2. Application**

The criteria below identify when assessments can be made in accordance with sections 1126, 1127, 1137, 1184, 1733, or 1735 of the CUIC.

Reason	Section	Time Limitation and Authority
Failure to file a return due to fraud or intent to evade.	1126, 1137, 1735*	No statutory limit. Section 1132 of the CUIC.
Failure to file a return without good cause. Fraud or intent to evade does <b>not</b> 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. Section 1132 of the CUIC.
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. Section 1132 of the CUIC.

Reason	Section	Time Limitation and Authority
Filed a deficient return. Fraud or intent to evade does not exist.	1127, 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 or within three years after the deficient return is filed, whichever period expires latest. Section 1132 of the CUIC.
Filed a deficient return. Fraud or intent to evade exists.	1127, 1137, or 1735*	No statutory limit. Section 1132 of the CUIC.
Failure of successor to comply with provisions of sections 1731 and 1732 of the CUIC.	1733	No statutory limitation. The EDD policy is within three years of the delinquency date of the quarter of acquisition, unless fraud or intent to evade is present.
Erroneous Refunds.	1184	Within three years from the date the refund was made. Section 1184 of the CUIC.

\*See Special Application for section 1735 below.

### 3. Special Application Under Section 1735 of the CUIC

In accordance with the provisions of section 1132 of the CUIC, the statute of limitations for section 1735 of the CUIC assessments 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.

### 4. Excess Wage Calculation

There are statutory taxable limits for UI, DI and ETT. If the statutory audit period begins on July 1 of a calendar year and the audit results in an assessment for misclassified workers, taxable wage limits must be considered. When the provisions of section 1132 of the CUIC are applied, wages paid for employment from January 1 to June 30 of a calendar year are applied to the statutory period

of an assessment and are included in computing the annual taxable wage limitation. For example, most employers would pay wages in excess of \$7,000 prior to the beginning of the statutory assessment period of July 1.

## **D. Waiver of Statute of Limitations**

### **1. Introduction**

Pursuant to section 1132 of the CUIC, the employing unit may waive the statutory limitation or consent to its extension. The *Extension of Time for Making Assessments and a Claim for Refund or Credit* (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 Statue of Limitation**

If an employer desires to file voluntarily payroll returns for any tax periods, the signed returns will be verified and, if accepted, they will be processed as self-assessments. The filed returns will be accepted regardless of whether contributions are paid or unpaid.

## **E. Jeopardy Assessments - Section 1137 of the CUIC**

### **1. Introduction**

The Director may issue an assessment under section 1137 of the CUIC if the collection of any contributions will be jeopardized due to delay. Whether collection is jeopardized due to delay will be based upon the facts in each particular case. An audit or investigation report will be prepared that supports with facts the issuance of a jeopardy assessment.

Section 1137.1 of the CUIC sets forth the sufficiency requirements:

“A jeopardy assessment may be made only upon a 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.
- (d) Any person liable for the employing unit's contributions, 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**

Any assessment issued under section 1137 of the CUIC will include a ruling letter stating the facts to support the finding that the collection of contributions is jeopardized by delay.

## **3. Expedited Hearing**

Jeopardy assessments require an expedited hearing procedure pursuant to section 1221 of the CUIC.

## **4. Justification of Jeopardy Not Found**

If an Administrative Law Judge (ALJ) or the California Unemployment Insurance Appeals Board (CUIAB) after a preliminary hearing finds insufficient facts to justify a jeopardy assessment under section 1137 of the CUIC, the assessment automatically converts to an assessment issued under section 1126 or 1127 of the CUIC.

## **5. Special Issue**

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 if the EDD becomes aware of new facts that jeopardize the EDD's ability to collect contributions and tax.

## **6. 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 EDD finds that *collection is in jeopardy due to delay*, the Department will establish the contributions not yet delinquent.

## **F. Issuing Estimated Assessments**

### **1. Introduction**

Estimated assessments will be levied under section 1126 and/or section 1127 of the CUIC. 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, but not limited to:

- Incomplete records.
- No return was filed for period(s) during which it is reasonable to believe that wages were paid, and/or
- An excessive amount of time would be required to calculate the assessment based on actual figures (e.g., Forms 1099, 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. Estimated subject wages may be based on:

- Any records which are available, even though they are incomplete.
- Prior quarterly returns showing the number of employees and amount of wages, and/or
- Statements from persons having knowledge of the employer's operations.

### **4. Proposed Assessment to Employer**

If the auditor finds it necessary to estimate any part of the assessment, they will provide a *Proposed Notice of Assessment (PNA)* (DE 6517P) and discuss the basis for their estimate at the closing interview with the employer.

During the course of an audit or investigation, if the EDD determines it must issue an estimated assessment, the auditor may issue an *Audit 10-Day Letter* (DE 6548) along with a *Proposed Notice of Assessment (PNA)* (DE 6517P) as notification that an estimated assessment will be issued. The explanation on the PNA should include the possibility of adjustment if necessary records are provided to the EDD prior to the issuance of an actual assessment.

## **G. Adjusting Estimated Assessments**

### **1. Cancellation or Adjustments**

Section 1136 of the CUIC 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 the 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 appropriate action to be taken when a return/report is filed after an estimated assessment was issued depends on several factors:

- When the return/report was filed (i.e., either before or after the finality date of the assessment).
- Whether the return/report is *paid* or *unpaid*.
- Whether the return/report is *signed* or *unsigned*.
- Whether the return/report is deemed reasonable.

## **H. Memorandum Assessments**

### **1. Introduction**

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

- Establish the liability pursuant to sections 1733, 1735 and 1735.1 of the CUIC of a person(s) other than the previously known tax debtor when it is learned that such person(s) is liable for the underlying tax liability.
- Afford such other person(s) the right to protest the liability determination.

### **2. Penalty Charges**

A penalty pursuant to section 1135 of the CUIC is charged on memorandum assessments.

### **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. Corporate Officer Memorandum Assessments**

Memorandum assessments levied pursuant to section 1735 of the CUIIC will establish liability against the responsible corporate officer or other persons having charge of the affairs of the debtor corporation or association employing unit.

Memorandum assessments levied pursuant to section 1735.1 of the CUIIC will establish personal liability on an individual (e.g., officer, major stockholder, or other person having charge of the business entity affairs) assessed pursuant to section 1128.1 of the CUIIC for the due and unpaid contributions, withholding, penalties (exclusive of penalties pursuant to section 1128 of the CUIIC), and interest assessed the employer based on money exchanged (laundered) to conceal the payment of wages.

### **I. Memorandum Assessments - Successor Liability**

#### **1. Successor Liability Memorandum Assessments**

Section 1731 and 1733 of the CUIIC 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.
- 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.
- That 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 determination that the EDD makes on a case-by-case basis.

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.



### **3. 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**

A dual employer is an employer that has more than one employer payroll tax account number. For assessment purposes, a return filed under one account will constitute a *return* filed for both accounts.

#### **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 of the CUIC.

### **2. Multiple Assessments**

It is permissible pursuant to section 1130 of the CUIC 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. Unity of Enterprise**

Section 135.1 of the CUIC defines a Vertical Unity of Enterprise as a change in entity or ownership with a continuity of control of the business enterprise. A new employing unit will not be created when there is an acquisition or change in the form or organization of an existing business enterprise, or severable portion thereof, and there is a continuity of control of the business enterprise. Continuity of control exists when the same person(s), entity(s), or other organization(s) is in control of the business before and after an acquisition or change in entity.

#### **Example:**

A business enterprise changes in entity form from a sole ownership to a corporation with the sole owner becoming the corporate president of the corporation.

When an assessment is required to be made for each entity type and it is not paid, separate assessments will be prepared for the liability in each separate ownership. However, if the employer concurs with the assessment and the entire liability is paid, one assessment may be prepared using the most current ownership.

**4. Liability is Not Delinquent**

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

Method	Procedure
Self-Assessment	Obtain a signed return/wage report (DE 9/DE 9C) and payment coupon (DE 88ALL) from the employer acknowledging the tax liability. The return can then be processed as a self-assessment.
Jeopardy - Section 1137 of the CUIC	When the EDD finds that <i>collection is in jeopardy due to delay</i> , the EDD will establish the contributions not yet delinquent in accordance with jeopardy provisions as described earlier in this chapter. If a wage report (DE 9C) is subsequently obtained, it will be noted thereon, <i>process for wage detail only</i> and sent to the Document Management Group (DMG) for processing. The assessment will be levied pursuant to section 1137 of the CUIC.

**5. Assessments Pursuant to Section 1184 of the CUIC**

Section 1184 of the CUIC provides that if a refund is erroneously issued to an employing unit, an assessment for the amount of contributions will be generated. Penalty and interest will be charged on any unpaid balance beginning 30 days after the notice of assessment and interest will accrue until the day of repayment.

**6. Advising Another Person or Business Entity to Violate Chapter 4 of the CUIC**

Section 1145 was added to the CUIC effective January 1, 2005. This section came into law as part of the State Unemployment Tax Act (SUTA) Dumping Prevention Act of 2004. Under this act, states were required to enact specific SUTA dumping prevention legislation.

If the EDD finds that a person or business entity knowingly advises another person or business entity to violate any provision of Chapter 4, Contributions and Reports of the CUIC, the EDD may assess the greater of:

- (1) A penalty of five thousand dollars (\$5,000).
- (2) Ten percent of the combined amount of any resulting underreporting of contribution, penalties, or interest required by law.

Section 1145 is an assessment pursuant to article 8 of the CUIC and, therefore, has appeal rights pursuant to section 1222 of the CUIC.

## **K. Assessments - Finality**

### **1. Application of Section 1222 of the CUIC**

Assessments pursuant to sections 1126, 1127, 1184, 1733, and 1735 of the CUIC are final 30 days after service of the *Notice of Assessment* (DE 6517), unless a petition for reassessment is filed within the 30 day period. An ALJ may grant an additional 30 days to file a petition for good cause.

### **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 of the Government Code). The CUIAB's Precedent Tax Decision No. P-T-364 sets forth the method of applying the above provisions, such as for mailing service which may be extended five days if the place of address is within the State of California, 10 days if the place of address is outside the State of California but within the United States, and 20 days if the place of address is outside the United States.

### **3. Application of Section 1221 of the CUIC**

Assessments pursuant to section 1137 of the CUIC are immediately final. In order for a petition to be timely, the employer must file it within 10 working days of the date of the *Notice of Assessment* (DE 6517). The amount of the assessment remains immediately due and payable pursuant to section 1137 of the CUIC.

### **4. Application of Section 1224 of the CUIC**

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

- Thirty days after the mailing of the order or decision of the ALJ.
- Thirty days after the mailing of the *Notice of Adjustment* (DE 6588) by the EDD 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 four of this section (i.e., substitute "CUIAB" for "ALJ").

## **L. Cancellation or Adjustment of Assessments**

### **1. Application of Section 1136 of the CUIC**

Section 1136 of the CUIC contains authority for the cancellation of an erroneous assessment or a portion thereof. 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 (i.e., the employer fails to appear for the hearing [nonappearance], or the employer withdraws the petition [withdrawal]).

### **2. When Section 1136 of the CUIC Does Not Apply**

Section 1136 of the CUIC does not authorize the EDD to cancel or decrease an assessment when the assessment has been the subject of a tax decision issued on the merits by an ALJ or the CUIAB. Section 1136 of the CUIC does not apply to paid assessments, however sections 1177 or 1178 may apply.

### **3. Increasing Assessments**

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 section 1126 of the CUIC and the employer has not filed a return/report (DE 9/DE 9C), subsequent assessments are also issued pursuant to section 1126 of the CUIC.

### **4. Adjusting the Assessment at the Hearing**

Pursuant to section 1223 of the CUIC, an ALJ has authority to decrease or increase the amount of any assessment under review at the hearing.

## **5. Section 1177 and 1178 of the CUIC**

Section 1177 of the CUIC authorizes the EDD to make a credit adjustment to a paid and either final or non-final erroneous assessment. Section 1136 of the CUIC does not apply to paid assessments. To be timely, a claim for refund or credit must be filed or discovered within the time limit prescribed under section 1178 of the CUIC:

- Within three (3) 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 the EDD becomes final, or
- Sixty days from the date of overpayment.

## **6. New Evidence Submitted**

A decision of the CUIAB is final and binding upon the Department, except for such action as may be taken by a judicial tribunal pursuant to section 410 of the CUIC.

An ALJ may grant a new hearing on the basis of the new evidence pursuant to section 1223 of the CUIC. If any petition is filed under this article within the time and meeting requirements prescribed, an ALJ shall review the matter and, if requested by the petitioner, shall grant a hearing. A hearing is not required on a petition if a prior hearing has been afforded the petitioner involving the same issues, but regardless of any prior proceedings, if the petitioner files an affidavit setting forth new and additional evidence in support of his or her petition, an ALJ may grant an additional hearing. 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 the EDD. The EDD may either approve or deny the claim. If the 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 the EDD to correct the amount of the assessment.

## **M. Service of Assessments**

### **1. Introduction**

Section 1131 of the CUIC 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 the EDD pursuant to section 1206 of the CUIC. These requirements apply to both automated assessments as well as to any prior manual assessments (DE 107PC).

## **2. Regular or Certified Mail**

Pursuant to section 1206 of the CUIIC, 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 pursuant to section 1137 of the CUIIC 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 pursuant to section 1137 of the CUIIC for any amount, the original assessment and each partner's copy will be sent by certified mail to the last address of record as it appeared on the EDD's records when the business ceased to operate.
- Except pursuant to section 1137 of the CUIIC, 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.

## **3. Billings versus Assessments**

Billings are generally issued for penalty and/or interest and for self-assessments (DE 9, DE 88ALL or DE 9ADJ) when there are no computation errors. If there are no computation errors, the employer does not have any appeal rights. If there are computation errors, the employer is issued an assessment that includes appeal rights. Billings are issued under authority of division 1, of part 1, of chapter 4, of article 7 of the CUIIC.

The EDD issues billings on the *Employer Account Statement* (DE 2176), which is described at the beginning of this chapter.

## Tax Audit Guidelines

### Chapter XVI

#### Completing the Case

##### **A. Wage Report Adjustment Schedule (DE 2026)**

###### **1. Use**

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

- Enter total subject wages, Personal Income Tax (PIT) wages, and/or PIT withheld when no report of wages has been filed.
- Adjust an erroneous report of total subject wages.
- Transfer total subject wages, PIT wages, and/or PIT withheld that were incorrectly reported under the wrong program employer payroll tax account number (Unemployment Insurance [UI]-Disability Insurance [DI], DI-only, or UI-only).
- Transfer total subject wages, PIT wages, and/or PIT withheld from one employer to another, or total subject wages, PIT 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 the EDD but was reported on the Form W-2 issued to the employee and/or will be reported by the employer on the Form 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:

- *Quarterly Contribution and Wage Adjustment Form* (DE 9ADJ)
- *Tax and Wage Adjustment Form* (DE 678) (for annual household employers only)
- *Quarterly Adjustment Form for Voluntary Plan Disability Insurance Employers* (DE 938)

###### **3. Identified Wages versus Unallocated Wages**

It is important that the auditor identify, for benefit purposes, the wage adjustments by employee, even if the Social Security number (SSN) is not known. Wages that are properly reported and identified ensure the prompt payment of benefits.

## Tax Audit Guidelines

### Chapter XVII

#### Case Review

##### **A. Integrated Case Review System**

The goal of the Field Audit and Compliance Division (FACD) Integrated Case Review System is to ensure correct and consistent application of the law, regulations, and Employment Development Department (EDD) policies and procedures that support the Department of Labor (DOL) audit requirements. Every case should fully meet the three goals of quality, which are timeliness, accuracy, and completeness. The FACD Integrated Case Review System is managed by FACD Audit Section in partnership with the Area Audit Offices.



## Tax Audit Guidelines

### Chapter XVIII

#### Refunds and Credits

##### **A. Overview**

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

The 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 legally due.

##### **B. Methods of Claiming Refunds or Credits**

###### **1. *Quarterly Contribution and Wage Adjustment Form (DE 9ADJ)***

The *Quarterly Contribution and Wage Adjustment Form* (DE 9ADJ) is designed to allow an employer to adjust tax return or wage report information previously reported to the EDD. The DE 9ADJ is the preferred form to use when filing a claim for refund or credit occurring in periods beginning January 1, 2011.

###### **2. Claim for Refund by Correspondence**

Section 1179 of the CUIC provides that, "Every claim for refund or credit shall be in writing and shall state the specific grounds upon which the claim is founded."

The employing unit may file a claim for refund or credit by writing a letter to the 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:

- Date of request for refund or credit
- Employer payroll tax 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 representative.

### **3. Amended Returns**

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

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

The 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 the DE 1977 allows the employer additional time to file a claim. The form must be submitted to the EDD prior to the expiration date of the quarter(s) included in the extension.

## **C. Time Requirements for Claiming Refund or Credit**

### **1. Section 1178 of the CUIC**

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

- Within three years from the last day of the calendar month following the close of the calendar quarter for which the overpayment was made, or
- Within six months after an assessment issued by the EDD becomes final, or
- Within 60 days from the date of overpayment.

#### **Example:**

An assessment is levied on May 1, 2012, for the quarter 11-4. The employer does not file a petition for reassessment and pays the assessment on June 30, 2013. The applicable time limits pursuant to section 1178(b) of the CUIC are:

- Statute for quarter 11-4 — three years from the last day of the month following the close of the fourth quarter 11-4 is January 31, 2015.
- Date of Assessment is May 1, 2012, and the assessment becomes final on June 1, 2012 — six months after the finality date is December 1, 2012.
- Date of payment is June 30, 2013 — 60 days from date of payment is August 29, 2013.

Therefore, January 31, 2015, 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 the EDD. The Area Audit Office (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 the EDD is final 30 days from the date of service unless a petition for review is filed. The provisions of section 1013 of the 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 section 1222 of the CUIC.

### **3. Finality - Claim Deemed Denied**

Section 1222 of the CUIC provides that if the 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 with an Administrative Law Judge (ALJ).

## **E. Authorization Required for Assignment of Refunds**

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

## **F. Protest of Benefit Changes**

### **1. Timely Protest Pursuant to Section 1034 of the CUIC**

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

The employer will be notified of the EDD's action on a protest in accordance with section 1035 of the CUIC.

## **G. Petition of Contribution Rate Change**

### **1. Correction of Any Error Pursuant to Section 1036 of the CUIC**

(a) The Director shall give notice, pursuant to section 1206, to the employer of the correction of any error which the director finds in any statement of account or statement of charges. Except in the case where fraud, intent to evade, misrepresentation, or willful nondisclosure is found, the notice of correction shall be issued prior to the expiration of the rating period to which a statement relates.

- (b) Any additional amount of contributions resulting from an increased contribution rate caused by the correction of any error that the director finds in any statement of reserve account or statement of charges shall be assessed within 180 days from the postmarked date of the notice of correction. These assessments shall be issued in accordance with article 8 (commencing with section 1126). However, these assessments shall become final on the last day of the calendar month following the calendar quarter in which the assessment is issued.
- (c) Any overpaid amount of contributions resulting from a reduced rate caused by the correction of an error that the director finds on any statement of reserve account or statement of charges shall be refunded within 180 days of the postmarked date of the notice of correction. These refunds shall be issued in accordance with article 9 (commencing with section 1176).

## **2. Protest Claim for Refund Pursuant to Section 1037 of the CUIC**

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 reserve account.

The 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 the 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.

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

## **H. Petition Conversion - Section 1179.5 of the CUIC**

Section 1179.5(a) of the CUIC provides that full payment made before an Administrative Law Judge (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.

Section 1179.5(b) of the CUIC provides that full payment made before the California Unemployment Insurance Appeals Board (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 bypass some of the administrative appeal procedures. This is especially important if the employer wishes to pursue the case in court.

For 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 section 1179.5 of the CUIC converts the decision into a petition to review a denial of the claim, the employer may then appeal directly to the court system.

## **I. Overpayments/Credits Which Include Employee Contributions**

### **1. Employer Refund of Erroneous Deductions**

Section 1178 of the CUIC and section 1178(c)-1 of Title 22, California Code of Regulations (CCR), 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.

## **J. 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 refund (or a portion of them).

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

The EDD's automated accounting system generates a *Notice of Overpayment and Claim for Refund* (DE 938C) to notify the employer of potential erroneous employee deductions when the amount of State Disability Insurance (SDI) reported exceeds the amount calculated in the EDD's automated accounting system, based on the amount reported by the employer as SDI taxable wages. The SDI and California Personal Income Tax (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 the EDD.

**K. When Refund Procedure for Erroneous Deductions is Not Required**

**1. Bankruptcy Court Action**

Refunds of erroneous employee deductions are 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 refund erroneous employee deductions on Voluntary Plan wages subsequently determined to be paid for services not in employment.

**L. 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:**

Tax Year	2015
DI Rate	0.9%
Taxable Wage Limitations	\$104,378
Maximum Deduction	\$939.40

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 SDI deductions of \$939.40 for the calendar year 2015.

## **M. 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 provided there is a continuity of ownership between them.

For 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 the 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. See section 1177 of the CUIC for refunds.

### **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 the 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. In order to claim a refund, the employer must state in writing the specific grounds in which the claim is found, the period covered, and the amounts claimed.

### **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 pursuant to section 1136 of the CUIC.

**N. Overpayments Pursuant to Section 1176 of the CUIC - Benefit Overpayments**

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

If the Area Audit Office (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 section 1176 of the CUIC, 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 section 1176 of the CUIC. The audit staff will note the name and Social Security number of the employee affected and the period during which benefits were drawn or the date on which a refund was made.
- Previously refunded SDI contributions overpaid by employees will be excluded from being refunded again in the audit.



## Tax Audit Guidelines

### Chapter XIX

#### Investigations

##### **A. Definition and Overview**

###### **1. Definition**

An investigation is an assignment in which specific issues are resolved or requested data is gathered. The scope of an investigation may include an entity's responsibilities, requirements, or status pursuant to the California Unemployment Insurance Code (CUIC) and Title 22, California Code of Regulations (CCR). 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 the Employment Development Department (EDD).
- Promote voluntary compliance.

##### **B. Proof of Credit**

###### **1. Purpose**

When an employer, who is subject to the Federal Unemployment Tax Act (FUTA), reports a conflicting amount of wages to the federal government as compared to the amount of wages reported to the EDD, a reconciliation must be made. An assessment may be issued by either the Internal Revenue Services (IRS) or the EDD.

Any question regarding the FUTA certification process should be addressed to the EDD FUTA Certification Unit at 1-916-654-8545.

##### **C. Bankruptcy, Probate, Assignment for the Benefit of Creditors, and Receivership Cases**

###### **1. Introduction**

These types of insolvency cases are normally handled by the EDD Collection Division, Special Procedures Section, Bankruptcy Group. The United States Bankruptcy Code dictates the need for the EDD to file a timely bankruptcy claim in order to participate in the distribution of the debtor's assets.

## **2. Assessments of the Debtor**

United States (U.S.) Code, Title 11, chapter 3, subchapter IV, section 362(b)(9) (D), in general, states it is not a violation of the automatic stay to issue notice of assessment for any tax while the debtor is in bankruptcy. The EDD may perform audits, investigations, and/or issue assessments that may involve pre-petition and post-petition liability while the debtor is in bankruptcy.

## **3. Bankruptcy Cases**

Petitions affecting the EDD are filed by individuals, partnerships, or corporations under the following chapters of U.S. Code, Title 11:

- Chapter 7 – Liquidation
- Chapter 9 – Adjustment of Debts of a Municipality
- Chapter 11 – Reorganization and/or Liquidation
- Chapter 12 – Adjustment of Debts of a Family Farmer or Fisherman With Regular Annual Income
- Chapter 13 – Adjustment of Debts of an Individual With Regular Income

## **4. Probate Cases**

Probate is a court procedure that includes all matters pertaining to the administration of estates, guardianships, and the validity of wills.

However, not all deceased person's estates go through probate and only proceedings filed in the Superior Court of the county in which the decedent was a resident at the time of death, or in any county in which the property is located, will the EDD file a claim.

There are two kinds of estates:

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

## **5. Assessment of Bankrupt Employers**

If an employer continues to pay wages after a bankruptcy petition is filed, separate assessment for pre-petition and post-petition liabilities may not be necessary.

## **6. Assignment for the Benefit of Creditors**

This is a process where an employer assigns all of its assets (assignor) to a third party (assignee) to be liquidated, with the proceeds to be disbursed to creditors. The EDD submits claims on Assignment for the Benefit of Creditors cases for all liabilities owed up to the date of the assignment since that date officially is the cease date of the employing unit.

## **7. Receivership Cases**

A receivership is a legal process filed by a creditor against an employer in Superior Court. The EDD handles these cases in a similar manner as a bankruptcy case, as any involuntary actions would be a violation of the court ordered receivership. A receiver is only legally obligated to the creditor that filed the action and is not required to take claims from other creditors, but they may. The EDD will contact the receiver to see if they are accepting claims or not. If they are, the EDD will file a claim and then monitor as if it was a bankruptcy case. If not, the EDD will monitor until closed but contact the employer for the liabilities owing. Assessments for liabilities are not affected by the receivership like a bankruptcy case as there is no pre-receivership or post-receivership unless the receiver runs the business in which case the assessment could be against the receivership estate for that period.

Any question regarding the bankruptcy process should be addressed to the EDD Collection Division, Special Procedures Section, Bankruptcy Group at 1-916-464-2888.

Tax Audit Guidelines

Chapter XX

Obstructed Claims

**A. Overview**

**1. Definition**

An obstructed claim is a request filed by a claimant or by the Employment Development Department (EDD) personnel with the Unemployment Insurance (UI) or Disability Insurance (DI) benefit office for a reconsideration of EDD's base wage computation, or denial of the initial benefit award. A Base Period is a 12-month period of time consisting of four calendar quarters. An obstructed claim is also used to determine if an employment 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 (e.g., covered for benefit purposes versus excluded, employee versus independent contractor).

**B. Obstructed Claim *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 UI or DI benefits online with the EDD.
2	The EDD's wage database is accessed to request a recomputation of wages – the <i>Notice of Unemployment Insurance Award</i> (DE 429Z). This request is automatically sent to the UI or DI office.

Step	Process
3	The claimant is mailed a printed copy of the DE 429Z ( <i>Notice of Award</i> [DE 429D] for DI) 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 <i>Recomputation Request</i> (DE 455), will be filed online with the EDD.
5	The DE 455 is sent to the Integrity and Accounting Division (IAD) Recomputation Unit to determine correct wages.
6	If the IAD does not clear the assignment, the obstructed claim investigation is initiated. The IAD sends an <i>Investigation Request Form</i> (DE 1153). It is sent to an Area Audit Office (AAO).

## 2. Status Investigation

The following chart summarizes the origination of a request for a status investigation. The purpose of a status investigation is to determine if the claimant was in an employment relationship and to establish wage credits if applicable, within the base period of a claim:

Step	Process
1	The UI benefit office mails a <i>Notice of Unemployment Insurance Claim Filed</i> (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 <i>Notice of State Disability Claim Filed</i> (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 respond on the DE 1101CZ or the DE 2503 with relevant facts about the claimant's eligibility. If the claimant was treated as an independent contractor, this is usually confirmed by the employer.
3	The employer is requested to return the DE 1101CZ or the DE 2503 to the benefit office. Submit facts in writing to the benefit office shown at the top of the form within 10 days of the mail date shown on the form.

Step	Process
4	When either of the forms indicates a status issue exists, the benefit office prepares a DE 455 requesting a status investigation and establishment of subject wages (if any) and transmits it to the IAD Recomputation Unit.
5	The IAD Recomputation Unit prepares a DE 1153 entering the information requested by the benefit office and transmits the DE 1153 to the AAO.

This procedure applies only to UI claims: If the AAO determines that an employment 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 1080CT). If the AAO determines that there is no employment relationship, the claimant is notified and may appeal the determination.

For DI claims, if it is determined that an employment relationship did not exist, the claimant is disqualified and notified of his or her appeal rights.

### C. Employer Protest

#### 1. Protesting the Determination

A *Notice of Wages Used for Unemployment Insurance Claim* (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 outlined in the DE 1545.

#### 2. Time Limits

The time limit for the employers to respond to a DE 1545 concerning a ruling is 15 calendar days from the mailing of the DE 1545, or 20 calendar days if the DE 1545 concerns the accuracy of wages used in the computation of a 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) if he/she believes them to be in error. Written protest must be made within 60 days of the mailing of the DE 428T. Instructions 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 1080CT) holds the claimant eligible and the reimbursable employer files an appeal that results in a reversal of the decision, this employer is still responsible to reimburse the EDD for actual benefits paid. A benefit overpayment is set up, and if the EDD collects from the claimant, the amount collected will be credited to the reimbursable employer.

### 2. Appeal Rights

A base period employer and a last employer who elect the reimbursable method of financing UI do not have reserve accounts. Therefore, they do not receive DE 428T forms. Reimbursable employers that submit timely eligibility information are entitled to receive determinations, which may result in a hearing.

#### **Example:**

A consultant filed a claim against his/her reimbursable employer. The reimbursable employer receives 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 who is the base period or last employer, the DE 1545R will show wages, but not charges. If the employer raised a status issue on the DE 1545R, the UI office will prepare a *Recomputation Request* (DE 455) and transmit it to the IAD. The IAD will issue the DE 1153 and transmit it to the applicable AAO. The AAO will respond to the IAD with its determination. A field office adjudicator will prepare the *Response to Employer Communication* (DE 4614) or the *Notice of Determination* (DE 1080CT). The DE 1080CT has appeal rights and will be mailed to the employer if the EDD holds that there is an employment relationship. If the employer appeals and receives a favorable decision (for example, claimant is held not to be an employee), the base period wages will be backed out. However, the employer will be billed for its percentage of any benefits paid to the claimant. Should benefit overpayments later be collected from the UI recipient, then the employer would receive a credit.

### 3. SEF Assignments

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

**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, the EDD will not consider wages to be less than the required minimum, as established by law.

**F. Irregular Wage Payments**

**1. Sections 1282 and 2657 of the CUIC**

Sections 1282 and 2657 of the California Unemployment Insurance Code (CUIC) 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 or her 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 section 1282 and 2657 of the CUIC will be limited to obstructed claim assignments.

**Example:**

Base period of claim 2014-4 through 2015-3.

- Claimant was employed from October 1, 2014, through December 15, 2015.
- Claimant received an unreported payment of \$12,500 on December 31, 2015, based on services through December 15, 2015.

Wages will be allocated as follows:

14-4	15-1	15-2	15-3	15-4
\$2,500	\$2,500	\$2,500	\$2,500	\$2,500



## Tax Audit Guidelines

### Chapter XXI

#### Special Issues

#### **A. Transfer of Wages and/or Contributions Between Employer Payroll Tax Accounts**

The following examples require the transfer of wages and/or contributions between employer payroll tax 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 ownerships 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 and/or contributions will be adjusted.

##### **2. Penalty**

The consolidated tax return/wage report is considered a tax return/wage report for each quarter. A penalty will be charged pursuant to section 1112 of the California Unemployment Insurance Code (CUIC) 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 pursuant to section 1112.5 of the CUIC will be charged for all quarters where tax returns/wage reports were not filed within 60 days of the delinquency dates.

##### **3. Specific Written Demand**

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

## C. Reserve Account Transfer Procedures

### 1. Introduction

#### **Optional Reserve Account Transfers:**

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.

#### **Mandatory Reserve Account Transfers:**

Reserve account transfers may be required if an employer transfers all or part of its business or payroll to another employer and at the time of the reserve account transfer both employers are under common ownership, management, or control pursuant to section 1061 of the CUIC.

#### **Prohibited Reserve Account Transfers:**

Reserve account transfers may be prohibited if the acquisition is determined to have been made for the purpose of obtaining a more favorable rate of contributions lower than that to which the employer would otherwise be entitled due to deliberate ignorance, reckless disregard, fraud, intent to evade, misrepresentation, or willful nondisclosure pursuant to sections 977, 1036, and 1052 of the CUIC. See *Information Sheet: SUTA Dumping and Unemployment Insurance Rate Manipulation* (DE 631SUTA) for more information.

### 2. Information Request from Successor Employer

A successor employer who is entitled to a transfer of reserve account may receive information from the EDD to safeguard their rights and to decide whether the transfer should be requested.

The EDD will give the employer the latest balance of the predecessor's reserve account and the 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 tax return/wage report after acquisition in the following manner:
  - Under the employer payroll tax account number of the predecessor.
  - Under its own employer payroll tax account number but using the reduced rate applicable to the predecessor.
  - As a consolidated tax return/wage report covering operations of both the predecessor and successor.
  - Under its own employer payroll tax account number along with the predecessor's tax return/wage report.

#### **4. Rate**

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

#### **5. Specific Information Furnished Applicant**

The EDD, 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 90 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 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 section 1029 of the CUIC.

- The predecessor has reentered 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 new employer rate of 3.4% 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 California Unemployment Insurance Appeals Board (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 - Unity of Enterprise**

There are two types of Unity of Enterprise (UE), Vertical and Horizontal. Sections 135.1 and 135.2 of the CUIC establish the criteria for UE determinations.

#### **Vertical UE**

A new employing unit shall not be created when there is an acquisition or change in the form or organization of an existing business enterprise, or severable portion thereof, and there is a continuity of control of the business enterprise.

#### **Horizontal UE**

Horizontal Unity of Enterprise occurs when two or more separate but related entities operate at the same time and are functionally united through control, operation, and use. The employing unit is assigned one employer payroll tax account number and one contribution rate.

Whenever there is a change in the employer's legal entity or when two or more related businesses have a common ownership and purpose, the EDD must determine if the new legal entity constitutes a new and separate employing unit for Unemployment Insurance (UI) experience rating purposes or if there is a single, continuing employing unit commonly referred to as a Unity of enterprise.

If there is not a single, continuing employing unit under the UE principle, the new employing unit will receive a new employer payroll tax account number and its own UI reserve account. If it is determined that the original and successor legal entities have a common ownership and purpose, the successor entity will be instructed to report under the original entity's employer payroll tax account number and utilize its existing UI reserve account.

The *Information Sheet: Unity of Enterprise* (DE 231UE) provides additional information regarding this topic.

## **E. Section 991 of the CUIC**

### **1. Introduction**

Sections 991(a) and (b) of the CUIC are used to determine whether a payment made in error and without negligence to another state that has an unemployment insurance law or to an agency of the federal government is considered timely with the EDD and not subject to penalty and/or interest.

### **2. Application**

A section 991 of the CUIC determination is involved when:

- Payment for contributions is mailed erroneously to another state or federal agency specified in sections 991(a) or (b) of the CUIC or to an admitted disability insurer, voluntary plan (VP) trustee, or to a self-insured plan as described in section 991(b) of the CUIC, or
- Wages subject to the CUIC have been reported and paid to another state and timeliness of the payment must be verified.

### **3. Qualification**

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

### **4. Personal Income Tax (PIT)**

Section 991 of the CUIC does not apply to PIT withholdings.

### **5. Disability Insurance (DI)/Employment Training Tax (ETT)**

DI and ETT are subject to the provisions of section 991 of the CUIC.

**F. Interstate Reciprocal Coverage Arrangement (IRCA)**

**1. Definition**

An 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. The IRCAs are approved by the Audit Section of the Field Audit and Compliance Division (FACD).

**2. Requested Forms**

Upon request, the EDD will send the employer transmittal and section 454(a)-1 of Title 22, California Code of Regulations (CCR) along with the following forms:

Form	Title
DE 231D	<i>Information Sheet: Multistate Employment (DE 231D).</i> This information sheet discusses how to apply sections 602 and 603 of the CUIC and how to calculate the Personal Income Tax (PIT) for multistate employees.
DE 2325	<i>Employer's Election to Cover A Multi-State Worker Under the California Unemployment Insurance Code (DE 2325)</i>
DE 2328	<i>Notice to Employee Regarding Unemployment Insurance and Disability Insurance Coverage (DE 2328)</i>

**3. Sections 602 and 603 of the CUIC**

Services which are *localized* (section 603 of the CUIC) 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 (section 602 of the CUIC) may be covered under the CUIC 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 sections 454(b)-1 through 454(b)-8 of Title 22, CCR, 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**

Each state 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. The listing contains the following:

- Name of vessel
- Jurisdiction (state)
- Employer
- Dates of coverage

## **H. Sole Shareholder Exclusion**

### **1. Requirements**

Pursuant to section 637.1 of the CUIC, 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 section 621(a) of the CUIC.

### **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 the 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 the 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**

Section 637.1 of the CUIC 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 tax return/wage report (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.

**7. Disclaimer Invalid After Effective Date**

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



Tax Audit Guidelines

Chapter XXII

Elective Coverage

**Elective Coverage**

The following forms are used in the elective coverage process:

<b>Form</b>	<b>Description</b>	<b>CUIC Section</b>
DE 1PE	<i>Selection of Financing Method; Election to Cover Excluded Services for Unemployment Insurance Purposes by a Public Entity or Indian Tribe</i>	710(c)
DE 3DI	<i>Quarterly Premium Notice for Disability Insurance Elective Coverage (DIEC)</i> Shows name, address, Social Security number, quarterly wage, and contribution liability.	708(a), 708(b), and 708.5
DE 3DI-I	<i>Disability Insurance Elective Coverage (DIEC) Rate Notice and Instructions for Computing Annual Premiums</i> A DI-only form concerning <i>reportable wages</i> , contributions for employers and self-employed individuals and mailed yearly with the fourth quarter DE 3DI.	708(a), 708(b), and 708.5
DE 3F	<i>Instructions for Reporting Wages and Contributions for Employers Who Have Elected Unemployment and Disability Insurance Coverage Under Section 708(a) of the California Unemployment Insurance Code (CUIC)</i>	708(a)
DE 945	<i>Annual Income Report for Disability Insurance Elective Coverage</i> Filed by participant to report net profit or loss as reported on IRS Schedule SE. Used to determine <i>wages</i> for DI contribution purposes.	708(a), 708(b), and 708.5

Form	Description	CUIC Section
DE 1375	<p><i>Notice to Employees – Elective Coverage Application for Unemployment Insurance - State Disability Insurance</i></p> <p>Poster distributed when application for UI and DI coverage is filed.</p>	701, 702, and 703
DE 1375A	<p><i>Notice to Employees – Termination of Elective Coverage Agreement for Unemployment Insurance – State Disability Insurance</i></p> <p>Poster distributed when UI and DI coverage is terminated.</p>	701, 702, and 703
DE 1375B	<p><i>Notice to Employees – Termination of Elective Coverage Agreement for Unemployment Insurance</i></p> <p>Poster distributed when UI coverage is terminated.</p>	701, 702, and 703
DE 1375C	<p><i>Notice to Employees – Elective Coverage Application for State Disability Insurance</i></p> <p>Poster distributed when DI coverage is filed.</p>	702.5
DE 1375D	<p><i>Notice to Employees – Termination of Elective Coverage Agreement for State Disability Insurance</i></p> <p>Poster distributed when DI coverage is terminated.</p>	702.5, 709, 710.4, and 710.5
DE 1378	<p><i>Application for Unemployment and Disability Insurance Elective Coverage for Employees Exempted Under the California Unemployment Insurance Code</i></p> <p>Form designed specifically for prospective coverage elections under section 702 and 702.1 of the CUIC, but also adapted for use when prospective coverage is requested under sections 701, 703, or 710, of the CUIC.</p>	701, 702, 702.1, 703, and 710

Form	Description	CUIC Section
DE 1378A	<p><i>Application for Unemployment Insurance, State Disability Insurance, and Paid Family Leave Elective Coverage Under Section 708(a) of the California Unemployment Insurance Code</i></p> <p>For employers who are sole proprietors, partners, or LLC managing members. Distributed upon request with information pamphlets, <i>For Your Benefit: California's Programs for the Unemployed</i> (DE 2320) and <i>Disability Insurance Provisions</i> (DE 2515). All active partners who elect simultaneously must be included on a single form.</p> <p>The employer should also be given the DE 3F with the application.</p>	708(a)
DE 1378DI	<p><i>Application For Disability Insurance Elective Coverage</i></p> <p>For self-employed, partners, or LLC managing members. Distributed upon request with a DI information pamphlet, DE 2515. In a partnership, each electing partner must file a separate return.</p>	708(b) and 708.5
DE 1378F	<p><i>Potential Liability for Unemployment Insurance Benefits When Electing the Reimbursable Method of Financing Under the California Unemployment Insurance Code (CUIC)</i></p>	801, 802, and 803(g)(2)
DE 1378J	<p><i>Application For Elective Coverage of Disability Insurance (Exempt Family Employment)</i></p> <p>Refer to <i>Information Sheet: Specialized Coverage (Elective Coverage for Exempt Workers)</i> (DE 231SC) for specific family members.</p>	702.5
DE 1378K	<p><i>Information Concerning Elective Coverage for State Disability Insurance (SDI) Under Section 702.5 of the California Unemployment Insurance Code (CUIC) (Except Family Employment)</i></p>	702.5

Form	Description	CUIC Section
DE 1378L	<p><i>Information Concerning Elective Coverage for State Disability Insurance (SDI) Only Under Section 709 of the California Unemployment Insurance Code (CUIC)</i></p> <p>Information for local public entities and Indian tribes.</p>	709
DE 1378M	<p><i>Application for Elective Coverage of State Disability Insurance Only – Local Public Entities and Indian Tribes</i></p> <p>Form to use if covering <b>all</b> employees for DI.</p>	709
DE 1378N	<p><i>Application for Elective Coverage of State Disability Insurance <b>Only</b></i></p> <p>Employers include public schools, public agencies, Indian tribes, and community college districts. Election is by bargaining unit or appropriate group.</p>	710.4, 710.5, 710.6, and 710.9
DE 1378P	<p><i>Information Concerning Elective Coverage for State Disability Insurance <b>Only</b> – Under Sections 702.6, 710.4, 710.5, 710.6, and 710.9 of the California Unemployment Insurance Code (CUIC)</i></p>	702.6, 710.4, 710.5, 710.6, and 710.9
DE 1478	<p><i>Elective Coverage for State Disability Insurance Approval</i></p> <p>Public Entities and Indian Tribes.</p>	702 and 710.6
DE 1549	<p><i>State Disability Insurance for Organizational Unit Approval</i></p>	710.4, 710.5, and 710.6
DE 3816DI	<p><i>Letter of Approval of Election Under Sections 708(b) and 708.5 of the CUIC</i></p>	708(b) and 708.5
DE 3817	<p><i>State Disability Insurance Elective Coverage Family Exemption</i></p> <p>Letter of approval for DI elective coverage for exempt family employees.</p>	702.5
DE 4807J	<p><i>Disability Insurance Elective Coverage Voluntary Inactivation</i></p>	704.1 and 705

Form	Description	CUIC Section
DE 6540	<i>DIEC Request for Information</i> Form prepared by auditor during the DIEC application process.	708(a), 708(b), and 708.5
DE 6545	<i>DIEC Withdrawal</i> Form prepared by auditor during the DIEC application process.	708(b) and 708.5
DE 6915	<i>Notification of Default Amount for DIEC Accounts</i> Form sent to those participants that did not respond to the DE 945 or DE 6921 that their account was given the minimum income allowed per the CUIC.	708 and 708.5
DE 6921	<i>Delinquency Statement for DE 945</i> Form statement sent if the DE 945 was not received.	708 and 708.5
DE 6923	<i>Delinquency Statement for DE 3DI</i> Form sent when the DE 3DI is not received for a specific quarter.	708(a), 708(b), and 708.5
DE 3816A	<i>Letter of Approval of Election</i>	708A
DE 3816DI	<i>Letter of Approval of Election Under Sections 708(b) and 708.5 of the CUIC</i> Informational pamphlet, DE 5137 sent with letter.	708(b) and 708.5
DE 3817DI	<i>Letter of Approval for DI Elective Coverage for Exempt Family Employees</i>	702.5