

THE RIGHT TO AUDIT

Title 72 P.S. §7272 states that the department or any of its authorized agents are authorized to examine the books, papers, and records of any taxpayer in order to verify the accuracy and completeness of any return made or, if no return was made, to ascertain and assess the tax imposed by Pennsylvania state law. This also includes the right to examine taxpayer records to verify compliance with laws pertaining to employer withholding of Pennsylvania personal income tax.

Department of Revenue is required to use audit procedures that are in conformity with state law as well as department regulations and policies. These procedures involve examination of source documents, journals, ledgers, schedules, tax returns, and other records used by the taxpayer to record sales and purchase transactions as well as the withholding of Pennsylvania personal income tax. The auditor may conduct a complete review or utilize test methods that allow for the examination of a representative portion (or sampling) of the taxpayer's business activities for the standard audit period. The audit findings must be documented in a report that includes a narrative, forms, schedules, and exhibits.

2022 AUDIT PROCESS

During 2022, the Department of Revenue will be taking a new approach to audits in the Restaurant Industry. Once a business is selected for audit, the department will make advanced purchases prior to conducting the actual audit. This enables the department to streamline the audit process and efficiently verify records for compliant taxpayers or identify potential underreporting including sales suppression.

ONE MONTH REVIEW:

The auditor will **select a month** in the current year to verify recordkeeping requirements and review the following with the taxpayer:

- What type of records are maintained?
- How gross sales, taxable sales, and sales tax collected are reported on the sales and use tax returns?
- How are wages and withholding are reported on the employer withholding return?
- How are income and expenses recorded for income tax returns?

SALES AND USE TAX:

The auditor will examine daily/monthly sales reports, bank statements, monthly merchant credit card statements and 3rd party delivery statements to verify the accuracy and completeness of the sales and use tax return for the selected month.

TRANSACTIONAL SALES RECORD:

Transactional sales records will be examined to verify:

- The department's purchases were properly recorded in the daily/monthly sales reports.
- Any unusual voided, cancelled, and missing sales.
- All sales tax collected was recorded and reported on the sales and use tax return.

EXEMPTION CERTIFICATES:

- If the taxpayer meets the requirements of the limited scope audit, the department will only assess invalid exemption certificates or any nontaxed sales subject to sales tax that were identified in the selected month.

PAYABLE INVOICES:

Payable invoices for the selected month will be examined to verify that sales or use tax was paid on all taxable items. If the taxpayer meets the requirement of the limited scope audit, the department will only assess errors identified in the selected month.

PAYROLL:

The business's payroll will be examined for the most recently completed quarter to verify that all wages were properly recorded and reported, all tax withheld was reported, and the tax was properly determined.

This review will be used by the Department of Revenue to establish a baseline for the business's activities that will be tracked to verify that the business remains compliant in the future. Based on the above findings, the department will determine if the business qualifies for a limited scope audit of the selected month or if they will be subject to a standard audit which includes additional periods.

LIMITED SCOPE AUDIT

An audit selected in 2022 during this initiative may be limited in scope to the selected month. To be eligible for a limited-scope audit, a restaurant must meet the following requirements:

- All returns including sales tax and employer withholding returns have been filed
- Outstanding tax liabilities have been addressed with the department
- Records necessary to conduct the audit were maintained and provided to the department's auditors for examination.

The records expected to be provided include:

- Transactional Sales Receipts
- Credit Card Slips
- Voided or Cancelled Sale Documentation
- Exemption Certificates
- Bank Statements
- Daily Sales Reports
- Monthly Sales Reports
- Monthly Merchant Credit Card Statements
- Federal Form (FF) 1099-K
- Monthly Statements from 3rd Party Delivery Companies such as Grubhub, DoorDash, etc.

IMPORTANT: The examination of the restaurant's records **must not** reveal any material underreporting of sales, sales tax collected, employee wages, or employee withholding. There must also be no evidence of sales suppression such as missing, reindexed, or altered sales receipts.

STANDARD AUDIT

If the examination reveals the requirements for a limited-scope audit were not met, this will result in an audit being performed for the standard audit period. The standard audit period includes the **current calendar year and the three previous** calendar years. In addition, taxpayers are required to provide the opportunity and physical facilities to enable the department to examine the records.

If the department identifies the underreporting of sales tax, all sales summary records for the standard audit period will be requested and examined to verify all sales tax charged and collected was reported. If complete and accurate summary records are not available, the department will estimate the tax due for the standard audit period. If the department's purchases are missing, reindexed, or altered or there are unexplained voids, cancellations, or missing receipts in the selected month, the department will estimate the tax due for the standard audit period using a ratio determined by the Department of Revenue based on reported information from similar restaurants. The ratio is commonly referred to as an "industry average" and is determined by comparing credit card totals to gross sales reported on the sales and use tax returns for restaurants of a comparable size in similar counties in Pennsylvania. Any willful attempt to evade the tax that is due by suppressing sales will also be referred to the Office of Criminal Tax Investigation for potential criminal review.

Any nontaxed sales, invalid exemption certificates, or purchase errors identified in the selected month may also be projected onto the standard audit period using an error rate.

Other procedures may be required based on the issues identified during the review. These procedures will be discussed with the taxpayer and additional documentation may be requested.

CONCLUSION OF THE AUDIT

When the audit work is complete, a meeting will be held between the taxpayer and the auditor. The taxpayer will be provided with an audit report containing a written narrative of the procedures performed, any issues identified, and a discussion of how the issues were addressed. The audit report will also contain the audit schedules that detail any audit findings. If the audit results in a tax deficiency, a Notice of Assessment will be sent to the taxpayer that summarizes the additional tax due and any applicable interest and penalty. The notice will also provide the date that an appeal must be filed by.

RESOURCES FOR SUCCESS

The Department of Revenue recognizes that understanding Pennsylvania tax laws and regulations related to the restaurant industry can be time consuming and complicated. To provide additional customer service to an industry significantly impacted by the COVID-19 pandemic, the department created a webpage revenue.pa.gov/restaurants. This webpage contains materials that will provide an overview on taxes, filing, and recordkeeping obligations as well as a link to a video on **Recordkeeping for the Restaurant Industry** and other helpful resources.



Recordkeeping for the Restaurant Industry