

Policy and Procedure: Early Determination of Audit Potential

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Purpose: The goals of the process for early determination of limited or no audit potential are to:

1. Develop procedures by which MTC's staff can identify audit activities that present little or no potential benefit to participating states or affected taxpayers;
2. Create a system to communicate that information to appropriate parties in a prompt and efficient manner; and
3. Enable MTC audit staff to work efficiently and to optimize the use of audit resources to provide greater benefit to participating states and taxpayers.

Policy: After sufficient review and as soon as prudently possible, an MTC auditor may determine that an audit has limited or no potential if, after initial review of the returns or of the taxpayer's records, the auditor concludes that:

1. There is little likelihood of an error with respect to the return(s);
2. The potential assessment or refund for a particular state for the period under audit would be less than \$1,000, and there is no other significant issue or material adjustment that would affect other tax years of the taxpayer, whether or not included in the audit period (The auditor may use estimates to determine if a potential assessment meets this guideline);
3. The amount of work needed to fully document proposed adjustments for a tax year or state, or for the entire audit outweighs the potential benefit to the state(s) or taxpayer(s).

Required documentation:

1. For an early determination of limited or no audit potential with respect to one or more tax years for the taxpayer, for a particular state or states, the auditor must document the reason(s) for the determination in the audit workpapers and include a discussion in the audit narrative.
2. For an early determination that the audit should be closed without adjustments due to limited or no audit potential, the auditor shall document the reasons for closing the audit in a report to the participating states.

Necessary approvals: The following levels of approval are necessary for an early determination of limited or no audit potential to be made:

1. For an early determination of limited or no audit potential with respect to one or more tax years for the taxpayer, for a particular state or states, the Audit Director must approve the determination.
2. For an early determination that the entire audit should be closed without adjustments due to limited or no audit potential, the states participating in the audit must approve the determination.

NOTE: The auditor, audit supervisor or Audit Director, in their discretion, may seek input from the affected states or the Audit Committee on any early determination of limited or no audit potential.

Notice to affected taxpayer(s):

1. If an early determination of limited or no audit potential has been made with respect to an audit, written notice shall be given to the taxpayer concerning the return(s) for which the determination has been made. The notice shall describe the nature and effect of the determination on the audit status of the tax return, including whether or not the return remains open for subsequent review by a state or states (example: net operating loss that could be carried forward).
2. If an early determination of limited or no audit potential affects a potential refund of taxes paid, the auditor shall notify the taxpayer of the nature of the potential refund and whether it may be necessary for the taxpayer to file amended returns in the affected states.
3. The written notice of a determination of limited or no audit potential must be given to the taxpayer at the time the audit schedules and audit adjustments are provided to the taxpayer. If appropriate, and after the auditor has consulted with any affected state(s), notice of the determination may be given to the taxpayer before the audit is concluded.

NOTE: For purposes of improving the audit nominating process, the Audit Director shall notify the Audit Committee of any determination that resulted in closure of an audit without adjustments.