

March 2011

This fact sheet is designed to educate taxpayers on the audit process. Since it's impossible to cover every conceivable situation, specific questions can be directed to the Department of Revenue's toll-free phone center at 1-800-TAX-9188.

Information found in this document rescinds and replaces all previously written information on this subject. All readers and users of this publication are responsible for keeping informed about changes in tax laws and regulations by reading the Department of Revenue newsletters, press releases, Tax Facts, and other documents published by the department.

## Audit Selections

If you are in business for any length of time, you can expect a visit from an auditor of the South Dakota Department of Revenue. This is no cause for alarm. Taxpayers are audited on a regular basis and you should not feel that your account is under suspicion for any tax liability.

Licensees are chosen for audit by computer or manually. Some factors which enter into the selection include the type of business, previous audits and tax filing history. Special effort is made to achieve wide geographic coverage as well as to include businesses where non-compliance has previously been found or is suspected. Some audits are randomly chosen to test compliance.

## Record-Keeping Requirements

Any business subject to sales, use or contractor's excise tax in this state must keep all business records for at least three years. Examples of business records include:

### **Gross Receipts:**

- Sales and billing invoices
- General ledger
- Cash register tapes - Journal tapes, detail tapes, Z tapes, guest checks
- Bank deposit slips and statements
- Sales and/or cash receipts journal
- Contracts
- Pricing and portion / service size information - menu prices

**Deductions:** All deductions to gross receipts allowed by law and claimed in filing returns must be supported by the following types of documents:

- Resale certificates
- Proof of exemption (exemption certificate or proof of government funds)
- Bills of lading or other proof of delivery
- Credit memorandums
- Bad debts as claimed on federal income tax returns

**Use Tax:** Tangible personal property or services on which sales tax has not been paid are subject to use tax. Services and use taxable items which are stored, used or otherwise consumed should be identified by:

- Purchase invoices
- Cash disbursement journal or check register
- Fixed assets schedule
- Inventory withdrawal records
- Depreciation schedules

The above records should be preserved for a period of three years and must include the normal books of account ordinarily maintained by the average prudent businessperson. All tax returns, as well as the schedules or working papers issued in connection with the preparation of tax returns, should also be preserved. In addition to the above records, the business should keep copies of supporting information, worksheets, schedules, etc. showing how the sales and use tax amounts were determined.

Anyone who fails to keep the records and books required, or refuses to exhibit these records to the Department of Revenue for the purpose of examination, could be found guilty of a Class 1 misdemeanor.

## Machine Sensible Records

Machine-sensible records are those records that are generated and maintained in an electronic format. State regulation requires all businesses utilizing machine-sensible records make those records available to the auditor upon request in the format commonly used by the business.

Machine-sensible records used to establish tax compliance shall contain sufficient transaction-level detail information so that the details underlying the machine-sensible records can be identified and made available to the department.

Businesses utilizing machine-sensible records upon request are required to provide a description of the business process

that created the records to include the relationship between the records and the tax documents prepared by the business.

All businesses utilizing machine-sensible records are required to maintain and store the records in such a manner that will facilitate use of the records by the department during an examination.

## The Audit Process

There are four basic steps to the audit process:

1. The taxpayer is contacted by a state revenue auditor to set up an audit appointment. A Notice of Intent to Audit will follow, confirming the commencement date of the audit.
2. In most cases, an opening conference is held on the commencement date of the audit. The taxpayer and auditor will discuss the company's procedures, operations, accounting system and records maintained. All records, books and documents are to be ready for presentation to the auditor on the commencement date of the audit. Any documents evidencing reduction, exemption or deduction of the tax are to be presented to the auditor **within 60 days** of the commencement date of audit. (Examples include resale certificates, exemption certificates and proof of delivery.)

If the seller has not obtained an exemption certificate or all relevant data elements for exemption certificates, the seller may, within one hundred twenty days subsequent to a request for substantiation, either prove that the transaction was not subject to tax by other means or obtain a fully completed exemption certificate from the purchaser. Any exemption certificate presented after one hundred twenty days need not be considered by the department.

**PURSUANT TO SDCL 10-59-7, DOCUMENTS PRESENTED AFTER THE 60 DAYS NEED NOT BE CONSIDERED BY THE AUDITOR.**

However, additional pertinent papers or documents shall be considered if all the following apply:

- (1) The additional pertinent papers or documents are material;
- (2) There were good reasons for failure to present other pertinent papers or documents as referenced in § 10-45-45 or 10-46-43, within the prescribed time period; and
- (3) The additional pertinent papers or documents are submitted within a reasonable time period prior to any hearing scheduled pursuant to § 10-59-9.

The 60-day time limit is strictly enforced.

The taxpayer may apply for an extension prior to the expiration of the 60-day limit, and, upon showing good cause,

an additional 30 days may be granted through an Agreement to Produce Records.

3. The length of an audit varies considerably, depending on the complexity of the business and the problems encountered. After a preliminary examination of your business, the auditor will decide whether to conduct a "detailed" or "sample" audit. In a detailed audit, the auditor examines all of your business records for the entire audit period. In most cases, a sample audit is appropriate, and the auditor will examine a representative sample of your business records.

Based on any errors found, an error factor will be computed and applied to the audit period.

4. When the auditor's work is completed, a conference is held so the auditor can explain the results. The taxpayer has a period of time to review the audit and provide additional information to support his position. At a closing conference, a proposed Certificate of Assessment is presented, reflecting any tax, penalty or interest owed by the taxpayer. After the audit is reviewed by the audit manager, the Certificate of Assessment is sent by certified mail to the taxpayer.

If an audit results in credit due the taxpayer, it will generally be applied to future tax obligations.

## Statute of Limitations

The department is precluded from collecting taxes owed more than three years prior to the audit. This limitation period does not apply in the following instances (SDCL 10-59-16):

- Any period during which the taxpayer was unlicensed;
- Any period during which the taxpayer filed a fraudulent return or failed to file a return;
- The three years preceding the date of mailing of a notice of intent to audit.

## Appealing an Audit

If the taxpayer believes the assessment is based on a mistake of fact or an error of law, a hearing before the Secretary of Revenue may be requested in writing 60 days from the date of the Certificate of Assessment. The request must contain a statement indicating the portion of the assessment being contested and the mistake of fact or error of law the taxpayer believes resulted in an invalid assessment. This request should be sent to the Secretary of Revenue. Hearings may not be requested for assessments of penalty or interest.

You will receive a notice of hearing stating the time and place of the hearing and the issues to be considered. Then, an attorney from the Department of Revenue will hold a pre-hearing conference, usually by phone, with you or your representative and the hearing examiner to decide what issues will be covered at the hearing. After the hearing, you will receive copies of the findings of fact, the conclusions of law, and the order.

The secretary's decision may be appealed to the circuit court within 30 days. Finally, you may appeal the circuit court's decision to the South Dakota Supreme Court.

### Audit Assessment Payments

Audit assessments are due on the date the certificate of assessment is issued. If payment is not received within 60 days of the certificate date, additional interest begins to accrue. If the taxpayer does not make arrangements for payment or request a hearing **in writing within 60 days** of the date of the Certificate of Assessment, collection procedures will be initiated by the Department of Revenue. This may result in liens being filed, a jeopardy assessment and distress warrant being issued, forfeiture of bond, or revocation of license.

### Penalties and Interest

A penalty of 10% of the tax, or \$10, whichever is greater, will be assessed on any return that is not filed within the time prescribed.

If there is any tax deficiency, interest will be assessed at the rate of 1-1/4% per month or part thereof, unless the failure to pay the tax was with the intent to intentionally avoid or delay the payment of tax, in which case interest will be assessed at the rate of 1-1/2% per month or part thereof.

### Talk to Us

For more information please visit us on the web at [www.state.sd.us/drr](http://www.state.sd.us/drr) or call our toll-free tax helpline at 1-800-TAX-9188.

**South Dakota**  
**Department of Revenue**  
**Business Tax Division**  
 445 East Capitol Avenue  
 Pierre, SD 57501-3100

#### **Aberdeen**

419 Moccasin Drive  
 Aberdeen, SD 57401-5085

#### **Rapid City**

4447 S. Canyon Rd., Suite 6  
 Rapid City, SD 57702-1889

#### **Watertown**

1505 10th Ave. SE, Suite 1  
 Watertown, SD 57201-5300

#### **Mitchell**

417 N. Main, Suite 112  
 Mitchell, SD 57301-2600

#### **Sioux Falls**

300 S Sycamore, Suite 102  
 Sioux Falls, SD 57110

#### **Yankton**

1900 Summit Street  
 Yankton, SD 57078-1951