

# RULES AND REGULATIONS

## Title 31—INSURANCE

### INSURANCE DEPARTMENT

[31 PA. CODE CHS. 71 AND 73]

[Correction]

#### Credit Insurance

An error occurred in the effective date to an Insurance Department rule which appeared at 28 Pa.B. 1401 (March 21, 1998). The correct effective date for the rule is June 19, 1998.

[Pa.B. Doc. No. 98-447. Filed for public inspection March 20, 1998, 9:00 a.m.]

### INSURANCE DEPARTMENT

[31 PA. CODE CH. 113]

#### Increase in Premium and Midterm Cancellation or Nonrenewal of Commercial Property and Casualty Policies

The Insurance Department (Department) hereby amends Chapter 113, Subchapter G (relating to increase in premium and midterm cancellation or nonrenewal of commercial property and casualty policies) to read as set forth in Annex A. This amendment under the authority of section 9 of the act of July 3, 1986 (P. L. 396, No. 86) (Act 86) (40 P. S. § 3409).

##### *Purpose*

Chapter 113 (relating to miscellaneous provisions) was initially promulgated to deal with problems posed by cancellations and nonrenewals of commercial property and casualty insurance policies. The authorizing statute, Act 86, was adopted in 1986 and was recently amended through the act of June 13, 1995 (P. L. 60, No. 10) (Act 10), which became effective August 12, 1995. Accordingly, the Department now seeks to modify Chapter 113 to be consistent with the revised statutory requirements. Specifically, Chapter 113 is being amended to reduce the 60-day notice of intent to increase premiums for commercial policies to a 30-day notice of premium increase, consistent with the statutory change. Further, Chapter 113 is being revised to eliminate the requirement that insurers provide written notice of estimated premiums to the insured at least 30 days prior to the renewal date, because the statute no longer mandates this requirement. Additional clarifying language has also been included consistent with the statutory changes.

##### *Comments*

Notice of proposed rulemaking was published at 26 Pa.B. 4434 (September 14, 1996) with a 30-day public comment period.

On October 14, 1996, the Pennsylvania Association of Mutual Insurance Companies (PAMIC) responded with comments. Additionally, comments were received from the Insurance Federation of Pennsylvania (IFP) on October 15, 1996, and from the Independent Regulatory Review Commission (IRRC) on November 13, 1996.

PAMIC noted that in addition to modifying Chapter 113 to be consistent with Act 10, additional clarifying language regarding the definition of "commercial property" or

casualty risks should be added. In that definition, PAMIC objected to the reference to Insurance Services Office (ISO) commercial lines manuals because other advisory organizations provide manuals and many insurers are not using ISO manuals. Any specific reference to one organization in a regulation would unfairly advantageously position that organization over others, and the reference would cause insurers to purchase manuals from multiple services and would serve to increase costs. The Department is currently revising each of its existing regulations, including Chapter 113, to ensure they are supported by statute, clearly written and necessary. It is the Department's intention to include any revision of the definition in a separate rulemaking. The Department intends to revise the definition through rulemaking as soon as possible.

PAMIC also noted concern regarding clarification of what constitutes "documentation" and "other documentation" in § 113.82(d)(1)—(4) (relating to notice of premium increases). Prior to the statutory change in Act 10, insurers mailed notices in advance of 60 days of renewal date. With the change, PAMIC felt it likely that insurers would satisfy the notice requirement by issuing actual renewals with premiums in advance of 30 days of renewal date. Some policies would be mailed to the policyholders while others may be mailed or hand delivered by agents. In response to that request for additional clarification, subsection (d)(4) was revised to provide specific documents such as renewal offers or other methods which are accepted and common within the industry that would reasonably demonstrate compliance.

The IFP's comments supported the Department's proposal as outlined at 26 Pa.B. 4434.

IRRC's comments restated PAMIC's concern with the definition of "commercial property" and "casualty risk," and the references to ISO manuals. IRRC suggested the Department follow-up with its separate rulemaking to eliminate specific references. The Department agrees that such a definition will be consistent with existing industry standards and will specifically include tenant-occupied dwellings and farm risks, the two categories questioned by PAMIC.

Regarding notice of premium increase, § 113.82(d)(4), IRRC restated that the Department left this provision purposely vague to accommodate new, innovative or different ways that insurers may use to notify insureds. IRRC appreciated the Department wanting to have the flexibility of a general "catch-all" clause which would accommodate any method of notice which would not fit into one of the three ways of giving and documenting notice of premium increases. However, IRRC recommended the Department further amend § 113.82(d)(4) to give one or more examples, preceded by the word "including." This approach would not compromise flexibility yet provide some further guidance to PAMIC's members and other companies. IRRC also suggested the Department incorporate a phrase such as "consistent with acceptable industry practices or standards," to ensure that whatever method used to give notice would still be within the general framework of acceptable insurance industry practice. The Department has incorporated language into this rulemaking to address this issue.

##### *Affected Parties*

Commercial property and casualty insurers transacting business in this Commonwealth and surplus lines insur-

ers who write insurance on commercial property and casualty risks in this Commonwealth are directly affected by the amendments. Policyholders, as recipients of cancellation and nonrenewal notices, are indirectly affected.

*Fiscal Impact*

*State Government*

The amendments will not have an impact on Department costs associated with monitoring industry compliance.

*General Public*

It is expected that savings to the insurance industry resulting from these amendments will be passed along to insurance consumers in the form of lower rates.

*Political Subdivisions*

The amendments have no impact on costs to political subdivisions.

*Private Sector*

It is estimated that the industry will realize a \$2.2 million savings per year resulting in the elimination of the estimated premium notice.

*Paperwork*

These amendments impose no additional paperwork requirements on the Department and reduce the paperwork requirements imposed on the insurance industry.

*Effectiveness/Sunset Date*

The amendments will become effective upon final publication in the *Pennsylvania Bulletin* as final rulemaking. No sunset date has been assigned.

*Contact Person*

The contact person is Helfried G. LeBlanc, Deputy Insurance Commissioner for Consumer Services and Enforcement, 1321 Strawberry Square, Harrisburg, PA 17120, (717) 787-6174.

*Regulatory Review*

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a)), on August 29, 1996, the Department submitted a copy of the proposed rulemaking, published at 26 Pa.B. 4434 to IRRC and to the Chairpersons of the House Committee on Insurance and the Senate Committee on Banking and Insurance for review and comment.

Under section 5(c) of the Regulatory Review Act, the Department also provided IRRC and the Committees with copies of the comments received, as well as other documentation. In preparing these final-form regulations, the Department has considered all comments received from IRRC, PAMIC, IFP, the Committees and the public.

Under section 5(c) of the Regulatory Review Act (71 P. S. § 745.5(c)), these final-form regulations were approved by the House and Senate Committees' on January 25, 1998. IRRC met on January 29, 1998 and approved the regulations in accordance with section 5(c) of the Regulatory Review Act.

*Findings*

The Insurance Commissioner finds that:

(1) Public notice of intention to adopt this rulemaking as amended by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P. L. 769, No.

240) (45 P. S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The adoption of this rulemaking in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statutes.

*Order*

The Insurance Commissioner, acting under the authorizing statutes, orders that:

(a) The regulations of the Department, 31 Pa. Code Chapter 113, are amended by amending §§ 113.81, 113.82 and 113.85—113.87 and deleting § 113.83 to read as set forth in Annex A.

(b) The Commissioner shall submit this order and Annex A to the Office of General Counsel and Office of Attorney General for approval as to form and legality as required by law.

(c) The Commissioner shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) The regulations adopted by this order shall take effect upon publication in the *Pennsylvania Bulletin*.

M. DIANE KOKEN,  
*Insurance Commissioner*

*(Editor's Note:* For the text of the order of the Independent Regulatory Review Commission relating to this document, see 28 Pa.B. 859 (February 14, 1998).)

**Fiscal Note:** Fiscal Note 11-130 remains valid for the final adoption of the subject regulations.

**Annex A**

**TITLE 31. INSURANCE**

**PART VII. PROPERTY, FIRE AND CASUALTY INSURANCE**

**CHAPTER 113. MISCELLANEOUS PROVISIONS**

**Subchapter G. INCREASE IN PREMIUM AND MIDTERM CANCELLATION OR NONRENEWAL OF COMMERCIAL PROPERTY AND CASUALTY POLICIES**

**§ 113.81. Definitions.**

The following words and terms, when used in this subchapter, have the following meanings unless the context clearly indicates otherwise:

*Act*—The act of July 3, 1986 (P. L. 396, No. 86) (40 P. S. §§ 3401—3409).

*Affiliated insurer*—An insurer who, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with another insurer.

*Agent*—An individual, partnership or corporation, licensed by the Department, who contracts with an insurer to sell insurance on behalf of the insurer. With respect to policies of insurance covering commercial property and casualty risks issued by eligible surplus lines insurers, the term means a surplus lines licensee as defined in section 1602 of The Insurance Company Law of 1921 (40 P. S. § 991.1602).

*Commercial property and casualty risk insurance*—Insurance within the scope of this chapter which is not personal risk insurance. The term includes insurance issued for commercial auto, farmowner's, business, profes-

sional or other commercial risks, such as businessowner's and commercial multiperil policies, aviation, credit, mortgage guaranty, and worker's compensation risks, except title insurance, fidelity and surety bonds, ocean marine risks, and workers compensation insurance covering employees subject to the Jones Act (40 U.S.C.A. §§ 731, 733a, 734, 737, 741a, 742, 745, 747—749, 751, 752, 863—865, 868, 870—872, 874 and 891—893), and Federal employees.

*Insurer*—An insurer authorized by the Department to transact business in this Commonwealth or designated as an eligible surplus lines insurer as defined in section 1602 of The Insurance Company Law of 1921.

*Named insured*—The insureds named on the declaration page of the insurance policy.

*Nonrenewal*—The failure by an insurer to issue and deliver a policy superseding at the end of the policy period one previously issued and delivered by the same insurer or affiliated insurer, where the renewal policy provides types and limits of coverage substantially equivalent to those contained in the policy being superseded. The term also includes the failure to issue and deliver a certificate or notice extending the term of a policy beyond its policy period or term with types and limits of coverage substantially equivalent to those contained in the policy being extended. The term does not include coverage provided under a policy of insurance that is renewed by the insurer under a new policy form approved by the Department if an appropriate disclosure notice is forwarded to the first named insured.

*Personal risk insurance*—Property or casualty insurance issued for personal, family or household purposes. Examples of policies of insurance issued for personal, family or household purposes are:

- (i) Policies used solely to provide homeowner's insurance, dwelling fire insurance on one to four family units if owner-occupied, or individual fire insurance on dwelling contents.
- (ii) Policies principally used to provide primary insurance on private passenger automobiles which are individually owned and used for personal or family needs.
- (iii) Policies of personal inland marine, personal theft, residence glass, personal liability insurance and personal excess.
- (iv) Policies on pleasure watercraft which are used for personal, or family needs.

*Policy of insurance*—A policy, certificate or binder issued or delivered in this Commonwealth by an insurer or agent covering commercial property or casualty risks. A policy with a policy period or term of less than 12 months or a policy period with no fixed expiration date is considered as written for successive policy periods of 12 months.

**§ 113.82. Notice of premium increase.**

- (a) Insurers shall provide the named insured advance notice of any increase in renewal premium at least 30 days before the upcoming policy renewal date.
- (b) An insurer may authorize its agents to provide the notice of premium increase to the named insured. The insurer is responsible for the agent's failure to provide a notice of premium increase 30 days or more in advance of policy renewal.

- (c) A notice of premium increase shall be provided to the named insured when a policy is issued by an insurer of a group of affiliated insurers that supersedes a policy issued by an insurer from the same group of affiliated insurers, and the premium will increase as a result of the superseding policy.

- (d) Insurers are responsible for documenting that advance notice was provided to the named insured. Insurers may satisfy this requirement by doing one of the following:

- (1) Maintaining a copy of the advance written notice provided to the named insured.
- (2) Documenting its file to reflect the date and time advance notice was provided to the named insured.
- (3) Providing documentation from its agent reflecting compliance with either paragraph (1) or (2).
- (4) Providing other documentation such as renewal offers or other methods which are accepted and common within the industry as would reasonably demonstrate compliance. The documentation will be evaluated at the sole discretion of the Department.

**§ 113.83. (Reserved).**

**§ 113.85. Midterm cancellation for material failure to comply with policy terms, conditions or contractual duties.**

An insurer may cancel in midterm a policy of insurance covering commercial property and casualty risks for material failure to comply with policy terms, conditions or contractual duties which require the insured to comply with safety standards and loss control recommendations, if the following apply:

- (1) The policy specifically provides that material failure to comply with safety standards and loss control recommendations may constitute a basis for cancellation.
- (2) The insurer has provided the named insured with written notice of the failure to comply with safety standards and loss control recommendations.
- (3) The insurer has provided the named insured with a reasonable opportunity to cure deficiencies with respect to safety standards and loss control recommendations.
- (4) The deficiencies with respect to safety standards and loss control recommendations have not been cured.

**§ 113.86. Notices of nonrenewal or cancellation forwarded by agents.**

An insurer shall be deemed in compliance with the requirement that notices of midterm cancellation or nonrenewal be forwarded by the insurance company directly to the named insured if an agent, who is authorized by an insurer to act on its behalf for purposes of providing notice of midterm cancellation or nonrenewal forwards notices of midterm cancellation or nonrenewal to the named insured. The insurer is responsible for the authorized agent's failure to meet the requirements for providing notice of midterm cancellation or nonrenewal to the named insured.

**§ 113.87. Return of unearned premiums.**

An insurer is responsible for the return of unearned premium to the named insured within the time period required by the act. An insurer may authorize its agents to return unearned premium to the named insured. The insurer is responsible for the agent's failure to return

unearned premium to the named insured as required by the act.

[Pa.B. Doc. No. 98-479. Filed for public inspection March 27, 1998, 9:00 a.m.]

## Title 58—RECREATION

### FISH AND BOAT COMMISSION

#### [58 PA. CODE CH. 51]

#### Petitions for Boating Regulations

The Fish and Boat Commission (Commission) by this order amends § 51.6 (relating to petitions for regulations). The Commission is publishing this amendment under the authority of 30 Pa.C.S. (relating to Fish and Boat Code) (code). The amendment concerns administration.

#### A. Effective Date

This amendment will go into effect immediately upon publication of this order in the *Pennsylvania Bulletin*.

#### B. Contact Person

For further information on the amendment, contact Laurie E. Shepler, Assistant Counsel, (717) 657-4546, P. O. Box 67000, Harrisburg, PA 17106-7000. This final rulemaking is available electronically through the Commission's Web site at <http://www.fish.state.pa.us>.

#### C. Statutory Authority

The amendment is published under the statutory authority of section 10 of the Sunshine Act (65 P. S. § 280) and section 506 of The Administrative Code of 1929 (71 P. S. § 186). This amendment also is published in accordance with section 204 of the act of July 31, 1968 (P. L. 769, No. 240)(45 P. S. § 1204) (CDL) which provides that an agency may omit or modify the procedures specified in sections 201 and 202 of the CDL (45 P. S. §§ 1201 and 1202) if the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in the order adopting the administrative regulation or change therein) that the procedures specified in sections 201 and 202 of the CDL are under the circumstances impracticable, unnecessary or contrary to the public interest.

#### D. Purpose and Background

Under § 51.5 (relating to correction of regulations), the Executive Director is authorized to take immediate corrective action on the Commission's behalf if the Executive Director or the Commission's staff discovers an error or omission in the text of a Commission regulation as published in the *Pennsylvania Code* or *Pennsylvania Bulletin*. It has been brought to the Commission's attention that § 51.6(f), as published in the *Pennsylvania Code*, erroneously refers to section 5122(c) of the code (relating to registrations, license permits, plates and statistics) instead of section 5121(c) of the code (relating to promulgation). The purpose of the amendment is to correct this incorrect reference.

#### E. Summary of Change

The Commission is amending § 51.6(f) to change section 5122(c) of the code to section 5121(c) of the code.

#### F. Paperwork

The amendment hereby adopted will not increase paperwork and will create no new paperwork requirements.

#### G. Fiscal Impact

The amendment hereby adopted will have no adverse fiscal impact on the Commonwealth or its political subdivisions. The amendment will impose no new costs on the private sector or the general public.

#### H. Public Involvement

Under section 204 of the CDL, an agency may omit the procedures specified in sections 201 and 202 of the CDL if the agency finds that these procedures are unnecessary. The Commission, therefore, did not publish this amendment as a notice of proposed rulemaking or solicit public comment.

#### Findings

The Commission finds that:

(1) An error was discovered in the text of 58 Pa. Code § 51.6(f) as published in the *Pennsylvania Code*.

(2) Under § 51.5, the Executive Director is authorized to take immediate corrective action on behalf of the Commission, including, if necessary, the issuance of an order to make the necessary correction, if the Executive Director or the Commission's staff discovers an error in the text of a Commission regulation as published in the *Pennsylvania Code*.

(3) Under the circumstances, the procedures of sections 201 and 202 of the CDL are unnecessary.

#### Order

The Commission, acting under the authorizing statutes, orders that:

(a) The regulations of the Commission, 58 Pa. Code Chapter 51, are amended by amending § 51.6 to read as set forth at Annex A, with ellipses referring to the existing text of the regulation.

(b) The Executive Director will submit this order and Annex A to the Office of Attorney General for approval as to legality as required by law.

(c) The Executive Director shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect immediately upon publication in the *Pennsylvania Bulletin*.

PETER A. COLANGELO,  
*Executive Director*

**Fiscal Note:** 48A-76. No fiscal impact; (8) recommends adoption.

#### Annex A

#### TITLE 58. RECREATION

#### PART II. FISH AND BOAT COMMISSION

#### Subpart A. GENERAL PROVISIONS

#### CHAPTER 51. ADMINISTRATIVE PROVISIONS

#### § 51.6. Petitions for regulations.

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(f) *Boating regulations.* For boating regulations, the staff will submit the petition, the staff report, the petitioner's response, if any, and the staff response, if any, to the Boating Advisory Board for review and consideration at its next regular meeting occurring more than 30 days

after the file is deemed complete. The Boating Advisory Board shall review the materials and provide advice and recommendations to the Commission as provided in section 5121(c) of the code (relating to promulgation).

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[Pa.B. Doc. No. 98-480. Filed for public inspection March 27, 1998, 9:00 a.m.]

## Title 61—REVENUE

### DEPARTMENT OF REVENUE

#### [61 PA. CODE CHS. 6, 8a AND 35]

#### Enforcement; Tax Examinations and Assessments

The Department of Revenue (Department), under the authority in section 2910-A of the act of June 30, 1995 (P. L. 139, No. 21) (72 P. S. § 9910-A) (Act 21) and section 270 of the Tax Reform Code of 1971 (TRC) (72 P. S. § 7270), by this order adopts amendments to delete § 6.22 (relating to further examination of books and records); to add Chapter 8a (relating to enforcement); and to amend § 35.1 (relating to tax examinations and assessments).

#### *Purpose of Amendments*

The purpose of these amendments is to advise taxpayers of the Department's interpretation of section 2915-A of the TRC (72 P. S. § 9915-A).

#### *Explanation of Regulatory Requirements*

Upon final publication of Chapter 8a, the language set forth in § 6.22 is no longer necessary; therefore, the section is being deleted in its entirety.

Section 8a.1 (relating to definitions) defines the following terms for use in this chapter: "audit period," "block sample," "clustered sample," "deviation from the mean," "outlier," "population," "range," "standard deviation," "standard error," "statistical estimation," "statistical sample," "stratum," "taxpayer," "test audit," "test period" and "transaction."

In accordance with section 2915-A(a) of the TRC, § 8a.2 (relating to examination) provides that the Department may examine all books, papers and records of a taxpayer or another person having possession of or dominion over records to: (1) Verify the accuracy and completeness of a tax return or tax report filed by the taxpayer and ascertain or assess tax or other liability owed to the Commonwealth; (2) Ascertain or assess tax or other liability owed to the Commonwealth if no tax return or tax report has been filed by the taxpayer.

Under section 2915-A(b) of the TRC, § 8a.3 (relating to audit types) provides that examination may be made by desk audit, field audit or another form of audit. Under § 8a.4 (relating to determination of liability), the Department may determine a tax liability owed by a taxpayer based upon the facts contained in a tax return, tax report or other information that may come into the Department's possession.

Section 8a.5 (relating to determination of audit method) provides that when the taxpayer does not have complete records or when the review of each transaction would be unduly burdensome on the Department to conduct an audit in a timely and efficient manner, the

Department will determine whether to examine all of the records of a taxpayer for an entire audit period, employ a test audit method or utilize a combination of audit methods. This section lists factors that the Department will consider in determining the audit method.

When a test audit is employed, § 8a.6 (relating to selection of sample) describes the basis for selection of the sample. The Department may utilize stratification levels in performing statistical sampling. When a block sample method is chosen, the Department will select blocks whose average is approximately equal to the estimated average of key characteristics for the audit period. Examples of key characteristics include sales, taxable to gross sales ratio, purchases or number of transactions.

Section 8a.6(1) explains that in determining whether to exclude the values of certain transactions from the sample, the Department will identify the transactions in the sample that are outliers. Outliers are sample values that are so different from the other sample values that it seems unlikely they are representative of the population being audited and, further, whose magnitude is such that including them in the projection could distort the audit findings. Paragraph (2) explains the process for identifying outliers. Paragraph (3) explains the steps that will be taken with respect to confirmed outliers. Paragraphs (4) and (5) detail the factors the Department will consider when determining whether to employ the test audit method in an audit of any Motor Carrier Road Tax and State and Local Sales and Use Tax or Hotel Occupancy Tax or Public Transportation Assistance Tax.

Section 8a.7 (relating to statistical estimation and software) provides that the audit results shall be computed by projecting the audit findings identified in the sample, as adjusted for outliers as provided in § 8a.6(3), to the population, regardless of whether the sample is a statistical sample or a block sample. Paragraph (1) states that when the Department employs the block sampling method, the standard error cannot be estimated. Paragraph (2) provides that when the Department employs the statistical estimation method, a standard error of the estimate shall be computed from the sample observations adjusted for outliers as provided in § 8a.6(3) to indicate the reliability of the estimated average, total or ratio. The Department may use software that has been designed in accordance with accepted statistical practices. The formulas utilized by the software will be available for examination by the taxpayer.

Section 8a.7(3) provides that except as otherwise mutually agreed to by the Department and the taxpayer, the number of observations in the sample will be chosen so that the projected sample will, on the average, yield an estimated precision within 25% of the mid-point of a 90% two-sided confidence interval. The sample size will be determined by using the sample size selection table set forth in paragraph (4). Additionally, the Department will increase the sample size upon the request of the taxpayer. The process of increasing the sample size will be repeated until mutual agreement is reached between the taxpayer and the Department on an acceptable number of observations.

Section 8a.8 (relating to test audit plan) provides that prior to conducting a test audit, the Department will set forth in writing a test audit plan and provide the taxpayer with an opportunity to review and comment on the plan. This section further provides areas that the plan will address including the statistical estimation

procedures and the taxpayer's right to request an increase in sample size.

Section 8a.9 (relating to audit findings) provides that at the conclusion of an audit, the Department will provide the audit findings and a copy of the work papers to the taxpayer, discuss the findings with the taxpayer, provide the taxpayer the opportunity to comment in writing and explain the procedure for the processing, assessing and appealing the audit findings. In accordance with section 2915-A(C) of the TRC, § 8a.10 (relating to taxpayer appeal) provides that a taxpayer may appeal the accuracy of a test audit. In accordance with section 2917-A of the TRC (72 P. S. § 9917-A), § 8a.11 (relating to applicability) provides that Chapter 8a applies to all taxes administered by the Department.

Section 35.1 (relating to tax examinations and assessments) is being amended by deleting the current text of subsection (a)(2) because similar language is in Chapter 8a.

#### *Affected Parties*

Taxpayers subject to audit by the Department may be affected by these amendments.

#### *Comment and Response Summary*

Notice of proposed rulemaking was published at 25 Pa. B. 4005 (September 23, 1995). The amendments are being adopted with changes to the proposed rulemaking.

The Department received comments from the public, the House Finance Committee and the Independent Regulatory Review Commission (IRRC). No objections or comments were raised by the Senate Finance Committee.

Though each comment received raised some unique concerns, many of the comments were similar in nature. Generally, the comments suggested that the proposed amendments did not provide sufficient guidance and detail regarding the use of statistical sampling and test audits. The Department agrees and has incorporated changes suggested by the comments received.

On October 22, 1997, the Department submitted the final-form regulations to IRRC and the Legislative standing committees. At the same time, the Department sent copies of the final-form regulations to the parties who had commented on the proposed rulemaking during the public comment period. Under section 5.1(d) of the Regulatory Review Act, the final-form regulations were deemed approved by the Legislative standing committees on November 12, 1997. On November 20, 1997, IRRC disapproved the final-form regulations.

On December 1, 1997, the Department notified the Governor, IRRC and the Legislative standing committees of its intent to proceed with adoption of the final-form regulations under section 7(a)(2) of the Regulatory Review Act (71 P. S. § 745.7(a)(2)). Under this section and section 7(c) of the Regulatory Review Act, the Department submitted a report to the Legislative standing committees and IRRC with revised final-form regulations. The revised final-form regulations reflect substantial input provided by Legislative committee staff, IRRC staff, public commentators and a private expert statistician contracted by the Department. Numerous telephone calls and drafting meetings were conducted with the identified parties for the purpose of resolving IRRC's concerns.

In response to IRRC's suggestion that a definition section be added, § 8a.1 has been amended to set forth

definitions of the following terms: "audit period," "block sample," "clustered sample," "deviation from the mean," "outlier," "population," "range," "standard deviation," "standard error," "statistical estimation," "statistical sample," "stratum," "taxpayer," "test audit," "test period" and "transaction." IRRC had also suggested adding the definition of "Department;" however, the term "Department" is defined in § 1.1 (relating to definitions).

IRRC also suggested that the Department define "unduly burdensome" when used in the phrase "unduly burdensome on the Department to conduct an audit in a timely and efficient manner" proposed in § 8a.1(d), now § 8a.5. It is the Department's position that the term cannot be defined because each case presents unique fact situations that must be considered individually. No one standard can be applied to all taxpayers. The Department has provided in § 8a.5 a listing of considerations that will be considered in determining the type of audit method to be employed.

In response to IRRC's request that the Department clarify proposed § 8a.1(a), § 8a.2 contains two paragraphs.

A public comment expressed concern that because section 2915-A was included in Article XXIX-A, Tax Amnesty Program, the definitions in section 2901-A of the TRC also apply to section 2915-A. Following this theory, the provisions of section 2915-A of the TRC and Chapter 8a would only apply to a taxpayer participating in the Tax Amnesty Program with regard to certain specified eligible taxes delinquent as of December 31, 1993. However, section 2917-A of the TRC specifically states that section 2915-A of Article XXIX-A shall apply to all taxes collected by the Department. Because the Legislature did not use the defined term "eligible tax" in this section, section 2915-A clearly applies to all taxes collected by the Department, not just "eligible taxes" under the Tax Amnesty Program.

The language proposed in § 8a.1(e) has been deleted and replaced by § 8a.5 with language that explains various factors the Department will consider to determine whether to examine all of the records of a taxpayer for an entire audit period, employ a test audit method or utilize a combination of audit methods.

In the final-form regulations disapproved by IRRC, the Department redrafted § 8a.5 (formerly proposed § 8a.1(e)) related to the list of factors the Department may consider in determining whether to conduct a complete audit, a test audit or a combination of audit methods. Section 8a.6(3) and (4) (formerly proposed subsection (f)(3) and (4)) was also amended to advise taxpayers of additional factors that the Department may consider in determining whether to conduct a test audit in Motor Carriers Road Tax, Sales Tax, Use Tax and Hotel Occupancy Tax. In the proposed rulemaking, these subsections had provided that the Department will consider these lists of factors in selecting an appropriate audit method.

IRRC has indicated that the distinction between the terms "may" and "will" in these sections is significant. The Department's sole purpose for creating these lists was to identify for taxpayers the types of factors that would be considered by the Department in its selection of an audit method. In conformity with IRRC's concerns, the Department has revised former subsections (e), (f)(3) and (f)(4) to provide that the Department will consider the identified factors.

In its disapproval order, IRRC also indicated that the final-form regulations do not provide assurance that the

liability determined by the Department using statistical sampling or test audits will be accurate within any degree of precision. IRRC also cited a letter from the majority and minority Chairpersons of the House Finance Committee dated November 18, 1997, which provides that the final-form regulations do not sufficiently address the risk of over-assessment. This comment suggested the use of the lower limit of either a 90% two-sided confidence interval or a 95% one-sided confidence interval, both of which are identical. The rationale for using the lower limit of these confidence intervals is that it would reduce the risk of over-assessment to no more than 5%.

After extensive review of this issue, it is the Department's opinion that it is inappropriate to use the lower limit of a confidence interval to determine an audit finding. The lower limit of a confidence interval is a very unlikely value for the true value. While it is true that the use of the recommended lower limit would reduce the risk of over-assessment to no more than 5%, it would also increase the risk of under-assessment to no less than 95%.

The Department believes that the use of the lower limit of a confidence interval is not in the best interests of the accurate enforcement of the Commonwealth's tax laws. The Department also believes that the use of the lower limit is unfair to taxpayers that have accurately reported their liabilities. The midpoint of the confidence interval is the most accurate estimate of the true value of the audit finding. Therefore, the Department's regulations utilize the midpoint of a 90% confidence interval to determine the audit finding.

Related to this concern is the issue of the level of precision that should be utilized in statistical estimation. Precision as used in the amendments is the range within which the average value will lie, with the degree of certainty specified in the confidence interval. Although IRRC and the Legislative standing committees have made no formal recommendation of an acceptable precision, discussions with staff and public commentators have suggested precisions ranging from 5 to 20%. Surveys of the practices of other states indicate that the precisions routinely used by State tax agencies in test audits range from 5 to 50%. In addition, many states do not calculate the precision of their test audits.

The Department has given a great deal of consideration to the establishment of a minimum precision level. Although a high precision (for example, 5%) may be an ideal goal, the Department believes it is not appropriate to mandate an extremely high precision level for the selection of an initial sample for the following reasons:

First, the precision of a sample as measured by the confidence interval cannot be estimated without first knowing the standard deviation or coefficient of variation of the sample. The data to be projected in tax audits is highly variable by nature and is constantly changing due to frequent statutory amendments and changes in business practices. This limits the Department's ability to estimate the coefficient of variation of a sample to be selected based upon historical data.

Therefore, it is the Department's position that the best method for estimating the precision of a sample in a tax audit is to select an initial sample and calculate its coefficient of variation and precision. This process provides a basis for making a more accurate estimation of the precision to be achieved by any additional sample

selected. If the taxpayer requests an increase in the number of observations being reviewed, the sample size can be increased. However, if the initial sample selected is satisfactory to both the taxpayer and the Department, there is no necessity to mandate that additional samples be selected.

Second, the use of stratification by the Department in conducting audits limits the potential range of the taxpayer's liability determined in a test audit. In a stratified audit, the transactions being audited are subdivided into several homogenous groups with respect to the characteristics being audited. For example, the transactions may be subdivided by dollar amount. In conducting a stratified audit, the Department may elect to do a complete audit on the subdivided groups containing the transactions with the largest dollar values. However, on the small dollar value groups, the Department may elect to use statistical estimation.

The Department has documented examples of its stratified audits when a review of only 5% of the total transactions in the sample resulted in the actual examination by the Department of over 50% of the total gross receipts that were the subject of the audit. Because complete audits were done on the transactions with the highest dollar values, and greatest impact on the taxpayer's liability, a low precision in the small dollar transaction strata may not significantly affect the taxpayer's ultimate tax liability.

Finally, it is the experience of the Department that many taxpayers do not want the Department to examine the number of samples required to obtain extremely high precision levels. This is due to the fact that the taxpayer must search for and identify the record for every sample transaction to be included within the projection. These records may be located in various facilities across the country and difficult to locate.

In addition, the taxpayer may be required by the Department to answer questions and provide additional verifications to support the records selected in the sample. This often requires the taxpayer to search for and identify additional records and identify the employees that were involved in the questioned transactions. These records and employees may also be located throughout the country. If the relevant employees have left the company, the taxpayer's reconstruction and verification of the record is made even more difficult.

In the case of stratified audits, the taxpayer's cost of pulling records related to and justifying large numbers of relatively small dollar transactions routinely outweighs any justification for an extremely high precision level. Therefore, the burden imposed on the taxpayer in selecting large sample sizes is often greater than the burden imposed on the Department to review the samples selected.

Accordingly, in response to the concerns on reasonableness and clarity of the procedures used for statistical sampling and test audits, the Department has revised the procedure in § 8a.7(3) for determining the number of observations to be selected in the sample. The revised procedure provides that the taxpayer and the Department may mutually agree on the number of observations to be chosen prior to conducting any sampling. In the absence of an agreement, the initial sample selected by the Department will be chosen so that the projected sample will on average yield an estimated precision within 25% of the midpoint of a 90% two-sided confidence interval.

The midpoint of a confidence interval is the best estimate of the population characteristic. Section 8a.7(4) provides a sample size selection table to be used in determining the number of observations to be selected in the initial sample.

After the selection and review of the sample, the standard error and estimated precision of the sample will be calculated and reviewed with the taxpayer. Upon the request of the taxpayer the size of the sample will be increased. The process of increasing the sample size will be repeated until mutual agreement is reached between the taxpayer and the Department on an acceptable number of observations. The Department believes that this process mitigates the concerns raised regarding a minimum precision level.

The Department has also significantly revised § 8a.6 in the revised final-form regulations relating to the procedures for the identification and treatment of outliers. Outliers are extreme values that are contained within the sample that are atypical of the population being audited.

The revised procedures require the Department to determine the transaction difference for each transaction in the sample. The transaction difference is the difference between the audited value of the transaction and its value reported to the Department. If a transaction difference is greater than 2% of the total audited amount of the total sample, the transaction is a suspected outlier. A confirmation test is then completed for each suspected outlier using a mathematical formula contained within § 8a.6(2). The test for an outlier is based upon the difference between the value of the outlier (either positive or negative) and the average of all other sampled values, divided by a measure of the dispersion of the other values (1/4 of the range).

Revised § 8a.6(3) provides that the Department will notify the taxpayer of all confirmed outliers and request evidence that would justify a smaller difference between the audited value and the reported value. If sufficient evidence is not provided, the outlier will be eliminated from the sample and audited independently. The audit finding on the outlier will be added to the result of the projection for the remaining sample to determine the total audit finding.

Excluding outliers from the sample projected and auditing them separately should on average yield a tax deficiency that is smaller than if a complete audit of all transactions were used to determine the tax liability owed to the Commonwealth. This results from the fact that there may be other extreme values in the population that are not included in the projections since they were not represented in the sample. This procedure facilitates the recommendation of IRRC and the Legislative standing committees that the audit procedures should minimize the risk of over-assessment.

In the final-form regulations disapproved by IRRC, § 8a.6 provided that:

When a test audit method is chosen to reduce burden, or because certain records are unavailable, *or for any other reason*, the concurrence of the taxpayer in the test audit plan will be sought. In the absence of *concurrence of the block sampling method*, the Department will select blocks.... (Emphasis added.)

IRRC identified two clarity concerns with this provision. First, IRRC stated that the phrase "or for any other

reason" should be removed from the final-form regulation because it lacks clarity and does not track the statutory language. The Department agrees and has removed the questioned language from the final-form regulations.

Second, IRRC stated that the phrase "In the absence of concurrence of the block sampling method" is confusing and lacks clarity. In response to comments made by IRRC at the public meeting on the final-form regulations and comments directed to IRRC by a public commentator requesting the removal of the references to the concurrence of the taxpayer, the Department has revised this section by deleting the references to the concurrence of the taxpayer.

Section 8a.7(2) is amended by deleting the term "generally" from the phrase "generally accepted statistical practices." It was brought to the attention of the Department by public commentators that the phrase has not been defined by any organization of expert statisticians or auditors. Therefore, it was concluded that the deletion of the term "generally" from the phrase did not change its meaning and the Department agreed to make the recommended change.

In response to a comment made by the public, IRRC and the House Finance Committee, proposed subsection (h), now § 8a.8 has been amended to provide that prior to conducting a test audit, the Department will set forth in writing a test audit plan and provide the taxpayer with an opportunity to review and comment on the plan. The section sets forth areas that the plan will address including the statistical estimation procedures and the taxpayer's right to request an increase in sample size.

A public comment suggested that if the Department determined a tax liability based on information outside of the tax return or tax report, that it will provide a copy of the information to the taxpayer for purposes of determining the accuracy of the information. The Department has responded to this comment in § 8a.9 by providing that at the conclusion of the audit, the audit findings and a copy of the work papers will be provided to the taxpayer. In addition, the auditor will also discuss the findings with the taxpayer, provide the taxpayer the opportunity to comment in writing and explain the procedures for the processing, assessing and appealing of the audit findings.

In response to a concern raised by IRRC and in accordance with section 2915-A(C) of TRC, a new § 8a.10 (relating to taxpayer appeal) provides that a taxpayer may appeal the accuracy of a test audit by providing clear and convincing evidence that the method used for selecting a statistical sample or block sample test period and determining the tax liability is erroneous, lacks a rational basis or produces a different result when the complete records are considered.

Finally, to avoid any conflict or confusion, the Department is amending § 35.1 by deleting the current text of subsection (a)(2) because similar language is now contained in Chapter 8a. New language has been added to subsection (a)(2) that states that audits will be conducted in accordance with Chapter 8a.

#### *Fiscal Impact*

The Department has determined that the amendments will have no significant fiscal impact on the Commonwealth.

#### *Paperwork*

The amendments will not generate significant additional paperwork for the public or the Commonwealth.

*Effectiveness/Sunset Date*

The amendments will become effective upon final publication in the *Pennsylvania Bulletin*. The amendments are scheduled for review within 5 years of final publication. No sunset date has been assigned.

*Contact Person*

The contact person for an explanation of the amendments is Anita M. Doucette, Office of Chief Counsel, Department of Revenue, Dept. 281061, Harrisburg, PA 17128-1061.

*Regulatory Review*

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a), on September 13, 1995, the Department submitted a copy of the notice of proposed rulemaking, published at 25 Pa.B. 4004, to IRRC and the Chairpersons of the House Committee on Finance and the Senate Committee on Finance for review and comment. In compliance with section 5(b.1) of the Regulatory Review Act, the Department also provided IRRC and the Committees with copies of all comments received, as well as other documentation.

Under section 5(c) of the Regulatory Review Act, IRRC and the Committees were provided with copies of the comments received during the public comment period, as well as other documents when requested. In preparing these final-form regulations, the Department has considered all comments received from IRRC, the Committees and the public.

Under section 5.1(d) of the Regulatory Review Act (71 P. S. § 745.5a(d)), these final-form regulations were deemed approved by the Committees on January 15, 1998. Under section 5.1(e) of the Regulatory Review Act, IRRC met on January 29, 1998, and approved the final-form regulations.

*Findings*

The Department finds that:

(1) Public notice of intention to adopt the amendments has been given under sections 201 and 202 of the act of July 31, 1968 (P. L. 769, No. 240) (45 P. S. § 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The final-form regulations are necessary and appropriate for the administration and enforcement of the authorizing statute.

*Order*

The Department, acting under the authorizing statute, orders that:

(a) The regulations of the Department, 61 Pa.Code, are amended by deleting § 6.22; amending § 35.1 and adding §§ 8a.1—8a.11 to read as set forth in Annex A.

(b) The Secretary of the Department shall submit this order and Annex A to the Office of General Counsel and the Office of Attorney General for approval as to form and legality as required by law.

(c) The Secretary of the Department shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon publication in the *Pennsylvania Bulletin*.

ROBERT A. JUDGE, Sr.,  
Secretary

(*Editor's Note:* For the text of the order of the Independent Regulatory Review Commission relating to this document, see 28 Pa.B. 859 (February 14, 1998).)

**Fiscal Note:** 15-371. No fiscal impact; (8) recommends adoption.

**Annex A****TITLE 61. REVENUE****PART I. DEPARTMENT OF REVENUE****Subpart A. GENERAL PROVISIONS****CHAPTER 6. TAX AMNESTY PROGRAM****§ 6.22. (Reserved).****CHAPTER 8a. ENFORCEMENT**

Sec.	
8a.1.	Definitions.
8a.2.	Examination of books and records.
8a.3.	Audit types.
8a.4.	Determination of liability.
8a.5.	Determination of audit method.
8a.6.	Selection of sample.
8a.7.	Statistical estimation and software.
8a.8.	Test audit plan.
8a.9.	Audit findings.
8a.10.	Taxpayer appeal.
8a.11.	Applicability.

**§ 8a.1. Definitions.**

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise.

*Audit period*—The period of time for which the audit is conducted.

*Block sample*—One or more groups of transactions selected as a unit from a population. For example, invoices numbered 100 to 200, or transactions for the months of May and October.

*Clustered sample*—A statistical sample in which blocks of adjacent transactions are selected with known probability. A statistical sample of transactions within the blocks may be selected, creating a two-stage statistical sample.

*Deviation from the mean*—The numerical difference between a single statistical observation and the mean (average) of all of the statistical observations.

*Outlier*—A statistical observation that appears to deviate markedly from other members of the sample from which it came.

*Population*—The total transactions during an audit period from which the sample is selected.

*Range*—The numerical difference between the largest and smallest statistical observations in the sample.

*Standard deviation*—The square root of the average squared deviation from the mean.

*Standard error*—The standard deviation divided by the square root of the number of statistical observations in the sample.

*Statistical estimation*—A method of estimating the numerical characteristics of a population, such as averages, totals or ratios, from a statistical sample and estimating the precision of the estimated characteristics.

*Statistical sample*—A selection of transactions in which each of the transactions in the population, or a stratum from it, has a known chance of being selected. The term is also known as a probability sample.

*Stratum*—A subdivision of the population in which the transactions within the subdivision are expected to be more uniform with respect to the characteristics being examined than the transactions across the subdivisions.

*Taxpayer*—A person, association, fiduciary, partnership, corporation or other entity required to pay, withhold or collect any tax that is administered by the Department.

*Test audit*—An audit of sampled transactions selected by either a block sample or a statistical sample method.

*Test period*—A time period or periods selected for the test audit; for example, the month of May.

*Transaction*—The term includes an entry, document, invoice or other record regardless of the method of creation or retention.

**§ 8a.2. Examination of books and records.**

The Department may examine all books, papers and records of a taxpayer or another person having possession of or dominion over these records to:

- (1) Verify the accuracy and completeness of a tax return or tax report filed by the taxpayer and ascertain or assess tax or other liability owed to the Commonwealth.
- (2) Ascertain or assess tax or other liability owed to the Commonwealth if no tax return or tax report has been filed by the taxpayer.

**§ 8a.3. Audit types.**

Examination may be made by desk audit, field audit or another form of audit.

**§ 8a.4. Determination of liability.**

The Department may determine tax liability owed by a taxpayer to the Commonwealth based upon the facts contained in a tax return, a tax report or other information that may come into the Department's possession.

**§ 8a.5. Determination of audit method.**

When the taxpayer does not have complete records or when the review of each transaction would be unduly burdensome on the Department to conduct an audit in a timely and efficient manner, the Department will determine whether to examine all of the records of a taxpayer for an entire audit period, employ a test audit method or utilize a combination of audit methods. In making this determination, the Department will consider the following factors:

- (1) The type of tax under audit.
- (2) The nature of the taxpayer's business.
- (3) The number of transactions in the population.
- (4) The adequacy and availability of the taxpayer's records.
- (5) Whether the taxpayer's business is cyclical or seasonal.
- (6) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
- (7) Other relevant factors.

**§ 8a.6. Selection of sample.**

When a test audit is employed, the selection of the block sample, statistical sample or clustered sample shall be based on the Department's analysis of the taxpayer's business operations and records, and shall reasonably represent the population from which the sampled transactions were selected. The Department may utilize stratifi-

cation levels in performing statistical sampling. When a block sample method is chosen, the Department will select blocks whose average is approximately equal to the estimated average of key characteristics for the audit period. Examples of key characteristics include sales, taxable to gross sales ratio, purchases or number of transactions.

(1) In determining whether to exclude the values of certain transactions from the sample, the Department will identify the transactions in the sample that are outliers.

(2) For the purpose of identifying outliers, the Department will determine the transaction difference for each transaction in the sample. The transaction difference shall be the difference between the transaction's audited value and its value reported to the Department. Any transaction difference with an absolute value greater than 2% of the total audited amount of the total sample shall be considered to be a suspected outlier. If the difference is no greater than 2% of the total audited amount of the total sample, no adjustment will be made. If the difference is greater than 2% of the total audited amount of the total sample, the following test will be done: Subtract the average of the transaction differences, omitting the suspected outlier, from the suspected outlier and divide by one-fourth of the range in values of the transaction differences, omitting the suspected outlier. If the absolute value of the ratio is four or greater, the suspected outlier shall be confirmed as an outlier. If there is more than one suspected outlier, this test shall be applied sequentially to all suspected outliers. If the population is stratified this process will be completed for each stratum in which sampling has been done.

(3) The following steps will be taken with respect to all confirmed outliers:

(i) The taxpayer will be notified concerning the outliers and requested to furnish evidence that will be considered by the auditor in determining the audited finding. If, upon examining the further evidence, the auditor agrees that a smaller difference between the reported amount and the audited amount is justified, the auditor will replace the original transaction by the adjusted finding.

(ii) If sufficient evidence is not provided, the outlier will be eliminated from the sample and audited independently. The audit finding on the outlier will be computed separately and the audit finding will be added to or, if negative, subtracted from the result of the projection for the remaining sample.

(iii) The sample values, adjusted for outliers as provided in subparagraphs (i) and (ii), will be used for projection of the total audit finding and its standard error.

(4) When determining whether to employ the test audit method in an audit of a tax under 75 Pa.C.S. §§ 9601—9622, (relating to motor carriers road tax) or a similar tax which may be enacted, the Department will consider the following factors:

- (i) The average fleet mileage as reported by the taxpayer.
- (ii) Whether the vehicles are company-owned, permanently leased from owner-operators, or a combination of both.
- (iii) The types of vehicles that make up the fleet.
- (iv) The type of fuel used to power the vehicles.

- (v) The geographical area in which the vehicles operate.
  - (vi) The type of commodities being hauled.
  - (vii) The total number of vehicles in the taxpayer's fleet.
  - (viii) The adequacy and availability of the taxpayer's records.
  - (ix) Whether the taxpayer's business is cyclical or seasonal.
  - (x) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
  - (xi) Other relevant factors.
- (5) When employing a test audit method in an audit of a State or local Sales and Use Tax or Hotel Occupancy Tax or Public Transportation Assistance Tax (72 P. S. §§ 7201—7282 and 9301; 53 P. S. §§ 12720.501—12720.509; 16 P. S. §§ 6150-B—6157-B) or a similar tax which may be enacted, the Department will consider the following factors:
- (i) The average gross sales.
  - (ii) The ratio of taxable sales to gross sales.
  - (iii) Whether the taxpayer's business is cyclical or seasonal.
  - (iv) Whether significant changes in the taxpayer's business or activities occurred during the audit period, such as discontinuing or adding a line of business.
  - (v) The adequacy and availability of the taxpayer's records.
  - (vi) Other relevant factors.

**§ 8a.7. Statistical estimation and software.**

The audit results shall be computed by projecting the audit findings identified in the sample, as adjusted for outliers as provided in § 8a.6(3) (relating to selection of sample) to the population, regardless of whether the sample is a statistical sample or a block sample.

- (1) When the Department employs the block sampling method, the standard error cannot be estimated.
- (2) When the Department employs the statistical estimation method, a standard error of the estimate shall be computed from the sample observations adjusted for outliers as provided in § 8a.6(3) to indicate the reliability of the estimated average, total or ratio. The Department may use software that has been designed in accordance with accepted statistical practices. The formulas utilized by the software will be available for examination by the taxpayer.
- (3) Except as otherwise mutually agreed to by the Department and the taxpayer, the number of observations in the sample will be chosen so that the projected sample will, on the average, yield an estimated precision within 25% of the midpoint of a 90% two-sided confidence interval. In determining the size of the sample, the Department will use the sample size selection table in paragraph (4). The estimated precision of the sample selected may be less than or greater than 25%, depending upon the variability in the sample data. The standard error and estimated precision will be calculated and reviewed with the taxpayer. The sample size will be increased upon the request of the taxpayer. The process of increasing the sample size will be repeated until mutual agreement is reached between the taxpayer and the Department on an acceptable number of observations.
- (4) The following sample size selection table identifies estimated sample sizes required to produce estimates with specified precision:

**Sample Size Selection Table**

Precision	Confidence Interval (2 sided)	Estimated Coefficient of Variation (CV)								
		0.25	0.50	0.65	0.75	1.00	1.50	2.00	3.00	5.00
5%	90% Normal	68	271	650	609	1,083	2,435	4,330	9,742	27,060
10%	Deviate	*	68	115	153	271	609	1,082	2,435	6,765
15%	1.645	*	31	51	68	121	271	481	1,082	3,007
20%		*	*	29	39	68	152	271	609	1,691
25%		*	*	*	25	44	97	173	390	1,082
30%		*	*	*	*	31	68	120	271	752
35%		*	*	*	*	23	50	88	199	552
40%		*	*	*	*	*	38	68	152	423

\* Fewer than 20 sample observations are required.

**§ 8a.8. Test audit plan.**

Prior to conducting a test audit, the Department will set forth in writing a test audit plan and provide the taxpayer with an opportunity to review and comment on the plan. The plan will describe the time period subject to audit, the records subject to review, methods for selecting records, statistical estimation procedures including the taxpayer's right to request an increase in sample size and

the manner in which any tax liability will be calculated based upon the records reviewed.

**§ 8a.9. Audit findings.**

At the conclusion of the audit, the audit findings and a copy of the work papers will be provided to the taxpayer. The auditor will:

- (1) Discuss the findings with the taxpayer.

(2) Provide the taxpayer the opportunity to comment in writing.

(3) Explain the procedures for the processing, assessing and appealing of the audit findings.

**§ 8a.10. Taxpayer appeal.**

The taxpayer may appeal the accuracy of a test audit by providing clear and convincing evidence that the method used for selecting a statistical sample or block sample test period and determining the tax liability is erroneous, lacks a rational basis or produces a different result when the complete records are considered.

**§ 8a.11. Applicability.**

This chapter applies to all taxes administered by the Department.

**ARTICLE II. SALES AND USE TAX  
CHAPTER 35. TAX EXAMINATIONS AND ASSESSMENTS**

**§ 35.1. Tax examinations and assessments.**

(a) *Examinations.* Tax examinations shall conform with the following:

\* \* \* \* \*

(2) *Audits.* Audits shall be conducted in accordance with Chapter 8a (relating to enforcement).

[Pa.B. Doc. No. 98-481. Filed for public inspection March 27, 1998, 9:00 a.m.]

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