



STATE BOARD OF EQUALIZATION

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Third District, Orange County

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

March 22, 2013

Dear Interested Party:

Enclosed is the Initial Discussion Paper on Regulation 1705, *Relief of Liability*. Discussion regarding proposed amendments to Regulation 1705 is scheduled for the Board's August 13, 2013 **Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 a.m. on April 4, 2013**, at the Board of Equalization, 450 N Street, Sacramento, California.

If you are unable to attend the meeting but would like to provide input for discussion, please send your submission to the above address or send a fax to 1-916-322-4530 before the April 4, 2013 meeting. Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in attending the meeting or presenting their comments.

If you plan to attend the meeting on April 4, 2013, or would like to participate via teleconference, please let staff know by contacting Mr. Michael Patno at 1-916-327-2045 or Michael.Patno@boe.ca.gov prior to April 2, 2013. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **April 18, 2013**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Kirsten Stark, Supervisor, Business Taxes Committee Team and Training Section, at 1-916-322-0849.

Sincerely,



Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB: map

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. David Hunter, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Mr. Alan Giorgi, Board Member's Office, Second District
Ms. Lynne Kinst, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris (MIC 83)
Mr. Jeffrey L. McGuire (MIC 43)
Mr. Jeff Vest (MIC 85)
Mr. David Levine (MIC 85)
Ms. Robert Tucker (MIC 82)
Mr. Bradley Heller (MIC 82)
Mr. Scott Claremon (MIC 82)
Mr. Lawrence Mendel (MIC 82)
Mr. Todd Gilman (MIC 70)
Ms. Laureen Simpson (MIC 70)
Mr. Bill Benson (MIC 67)
Mr. Joe Fitz (MIC 67)
Mr. Wayne Mashihara (MIC 46)
Mr. Kevin Hanks (MIC 49)
Mr. Bradley Miller (MIC 92)
Ms. Kirsten Stark (MIC 50)
Mr. Michael Patno (MIC 50)
Ms. Lynn Whitaker (MIC 50)

INITIAL DISCUSSION PAPER

Proposed revisions to Regulation 1705, *Relief from Liability*, regarding Revenue & Taxation Code Section 6596 relief to a business

Issue

Whether to revise Regulation 1705, *Relief from Liability*, to clarify that a business is relieved from the liability to pay tax based on erroneous advice provided to a different registered person operating a business in the same industry, provided that the two businesses have common controlling ownership, as specified, and share accounting functions such that the advice provided would reasonably be relied on by both businesses.

Background

Revenue and Taxation Code section (Section) 6596 provides relief from tax, interest, and penalty charges due on a transaction if the Board determines that the taxpayer failed to pay tax because it reasonably relied on erroneous written advice from the Board. For relief to apply, the Board must have received a written request for advice on the activity or transaction, the request must have identified the taxpayer to whom the advice applied, and the request must have fully described the facts and circumstances of the activity or transaction. Regulation 1705(c) states that, “[p]resentation of the person’s books and records for examination by an auditor shall be deemed to be a written request for the audit report.”

Section 6596 subdivision (d) states that, “[o]nly the person making the written request shall be entitled to rely on the board’s written advice to that person.” Section 6005 defines a person as any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit. Generally, taxpayers cannot obtain relief by relying on a written opinion given to another person, even if the transactions are similar. However, a person may rely on advice given to the person’s representative provided that the representative identifies the person for whom the advice is requested.

Regulation 1705, *Relief from Liability*, explains the provisions of Section 6596 in more detail. The regulation has been amended twice to explain who can rely on the written advice given. In 1999, Regulation 1705 was amended to extend Section 6596 relief to trade or industry association members when an association requests written advice on behalf of its members. In 2009, the regulation was amended again to extend the relief to franchisees who relied on advice provided to their franchisor. For both, in order to obtain relief under Section 6596, the members and franchisees must be identified in the association’s and franchisor’s request for advice, respectively. In addition, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

INITIAL DISCUSSION PAPER

Proposed revisions to Regulation 1705, *Relief from Liability*, regarding Revenue & Taxation Code Section 6596 relief to a business

At the October 2012 Board Meeting, the Board heard a Sales and Use Tax appeals case for Taxpayer/Business ABC (ABC). ABC argued that they followed the advice provided during the prior audit of Taxpayer/Business XYZ (XYZ). The claimant stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Records revealed that XYZ owns more than 50% of ABC. Therefore, it was argued that advice provided to XYZ through their audit, was indirectly provided to ABC as well. Following the meeting, staff was asked to clarify Regulation 1705 and explain when written advice provided to a business would also be applied to another business.

Discussion – Can reliance be extended to the “same person”?

Regulation 1705(e) extends relief to association members and franchisees in certain cases; staff proposes that when a business (i.e. person) receives erroneous written advice from the Board, relief can also be extended in limited circumstances to a related entity in the same industry provided both the business and the related entity share common controlling ownership and share accounting functions. Under such circumstances, it would be unreasonable to have the same accounting staff, under the direction of common controlling ownership, rely on written advice provided to one business but not rely on that advice for the other.

Staff proposes to revise Regulation 1705, subdivision (a)(3), to clarify that a person, as used in Section 6596, may include an entity engaged in business in the same industry as the person that received the erroneous written advice if they have common controlling ownership, i.e. the person that received the advice has a verifiable controlling share of the business seeking relief or there is a common majority owner or shareholder with a verifiable controlling share in each business involved. Further, the business seeking relief must share accounting functions with the person that received the advice. For example, they have the same accounting staff preparing their returns or the same accounting firm maintaining their books and records. Such entities would only be entitled to relief if the activity or transactions in question involve the same facts and circumstances as those presented in the written inquiry.

Additionally, staff believes the phrasing “legal or statutory successor” should be moved within the subdivision so that relief is not extended to the successors of those same entities discussed herein. Staff’s proposed revisions to Regulation 1705 are attached in Exhibit 1.

By clarifying the meaning of the term “same person” for the purposes of section 6596, staff does not intend to otherwise affect or change the definition of “person” for the purposes of the Revenue and Taxation Code.

INITIAL DISCUSSION PAPER

Proposed revisions to Regulation 1705, *Relief from Liability*, regarding Revenue & Taxation Code Section 6596 relief to a business

Summary

Staff proposes amendments to Regulation 1705 to clarify who may rely on erroneous written advice for purposes of seeking Section 6596 relief from the liability to pay tax. Staff welcomes any comments, suggestions and input from interested parties regarding the issue.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 3/19/2013.

REGULATION 1705. RELIEF FROM LIABILITY.

Reference: Section 6596, Revenue and Taxation Code.

(a) IN GENERAL. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the same person to whom it was originally issued ~~or a legal or statutory successor to that person~~. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited. The advice received during a prior audit may, in certain limited circumstances, also be relied on by certain related entities provided that they meet the definition of the "same person" as set forth below. ~~or by a legal or statutory successor to that person.~~

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

For the purposes of this regulation the term “same person” includes a legal successor, statutory successor, or an entity that (1) is engaged in the same line of business as the person to whom the advice was given, (2) shares common controlling ownership with the person to whom the advice was given, and (3) shares centralized accounting functions with the person to whom the advice was given. These elements must be established as existing at the time the written advice was provided. For the purposes of this section, common controlling ownership means there is a common owner with a controlling share in each business. A controlling share may be established by verifiable evidence of over 50% ownership or a majority share in the entity. For the purposes of this section centralized accounting functions may be evidenced by:

1. Simultaneously prepared sales and use tax returns.
2. Shared accounting staff or a shared outside firm.
3. Shared accounting procedures.
4. Quantifiable control of the accounting practices of each business by common ownership or management.

For an entity to receive relief based on advice provided in the written communication, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry.

(b) ADVICE PROVIDED IN A WRITTEN COMMUNICATION.

(1) Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(2) A person may write to the Board and propose a use tax reporting methodology for qualified purchases subject to use tax. If the Board concludes that the reporting method reflects the person's use tax liability for the defined population, then the Board may write to the person approving the use of the reporting method. The approval shall be subject to certain conditions. The following conditions shall be included in the approval:

- (A)** The defined population of the purchases that will be included in the reporting method;

- (B) The percentage of purchases of the defined population that is subject to tax;
- (C) The length of time the writing shall remain in effect;
- (D) The definition of a significant or material change that will require rescinding the approved reporting method; and
- (E) Other conditions as required.

The written approval of the use tax reporting methodology is void and shall not be relied upon for the purposes of Revenue and Taxation Code section 6596 if the taxpayer files a claim for refund for tax that had been reported based upon this reporting method.

(c) WRITTEN ADVICE PROVIDED IN A PRIOR AUDIT. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

(d) ANNOTATIONS AND LEGAL RULINGS OF COUNSEL. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

- (1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or
- (2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) TRADE OR INDUSTRY ASSOCIATIONS OR FRANCHISORS. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.