State of California

Board of Equalization
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Memorandum

To : Honorable Betty T. Yee, Chairwoman
Honorable Judy Chu, Ph.D., Vice Chair
Honorable Bill Leonard
Honorable Michelle Steel
Honorable John Chiang

Date : July 31, 2007

From : Kristine Cazadd
Chief Counsel

Subject : **August 14, 2007 - Item J**
Request for Authorization to Publish Amendment to Regulation 1699

At your meeting in Culver City in June, you heard a case that included the issue of whether the petitioner, who was being held liable for predecessor liability as provided in California Code of Regulations, title 18, section (Regulation) 1699, could also be held liable for the fraud penalty imposed on the successor taxpayer. The Appeals Division representative, Tax Counsel IV David H. Levine, noted that subdivision (f) of Regulation 1699 is not "artfully" written, but that our interpretation of it has been consistent. After adopting the recommendation of the Appeals Division in the case before it, the Board also directed staff to rewrite subdivision (f) for purposes of clarification and bring the proposed amendment to the Board for authorization to publish.

Attached is our proposed amendment to the regulation. Since we have determined that the entire subdivision is unclear (not just the fraud issue specifically discussed during the Board's June meeting), we have rewritten the entire subdivision to clarify the procedures for surrendering a seller's permit, and the potential liabilities incurred for failing to do so. We discuss the highlights below.

The current regulation requires that a person not actively engaged in business as a seller of tangible personal property "surrender" his or her permit, and this is consistent with Revenue and Taxation Code section 6071.1 which provides for predecessor liability when a permit holder fails to surrender his or her permit upon transfer of the business. The current regulation also notes when the permit "need not be delivered to the Board." Nevertheless, the current regulation does not impose predecessor liability on a predecessor who notifies the Board of the transfer but does not deliver the permit. That is, in practice, we have focused on whether the Board knew of the transfer, *not* whether there was a physical return of the permit (though such a return could constitute sufficient notice). The proposed amendment harmonizes the statutory requirement for surrender of the permit with the practical reality that actual notice to the Board is sufficient. It does so by essentially defining "surrender" in subdivision (f)(1) as notifying the Board to cancel the permit (section 6071.1 does not provide that "surrender" means actual physical return of the permit to the Board). The remainder of the subdivision then focuses on whether the Board has been notified to cancel the permit.

Subdivision (f)(2)(A) explains one satisfactory method of notifying the Board is to deliver the actual permit to the Board and request it be canceled, and another is written notice to the Board

requesting that the permit be canceled. The subdivision also notes that the permit holder may provide this notice to the Board orally, but states that it will be presumed that such notice was *not* given if the Board's records do not reflect such notice.

Subdivision (f)(2)(B) covers situations where the Board receives notice of the transfer of a business from other sources. It regards this situation "as having received notice of cancellation of the permit," to again harmonize with the surrender requirement (notice of transfer being equivalent to notice of cancellation which is equivalent to surrender of the permit). As with oral notice from the permit holder, this provision presumes that the Board did *not* receive such notice unless our records so reflect.

Finally, subdivision (f)(3) explains the limitation on the predecessor's liability set forth in section 6071.1, and includes the regulatory limitation on the fraud penalty, making it clear that the fraud penalty *can* be imposed on the predecessor where the ownership of the successor who committed fraud is substantially similar to the predecessor (i.e., 80 percent or more similar ownership).

The purpose of this proposal is to more clearly explain in the regulation our application of the predecessor liability rules, and not to make any changes to those rules. For ease of reading, the attachment includes *only* subdivision (f), rather than the entire regulation, and does not use underline and strikeout; however, the underline and strikeout version is available upon request. The proposed amendment to subdivision (f) is on pages 1 and 2 of the attachment, and the current provision is on page 3 of the attachment for purposes of comparison. If the Board authorizes publication, the proposed amendment will be formatted in the standard underline and strikeout format required for regulatory amendments.

If you have any questions regarding this proposed amendment to Regulation 1699, please contact Tax Counsel IV David H. Levine at (916) 324-2192.

Approved

Ramon J. Hirsig by KEC
Ramon J. Hirsig
Executive Director

Attachment
KEC/te

cc:	Mr. Ramon J. Hirsig	MIC:73
	Mr. Randie L. Henry	MIC:43
	Ms. Anita Gore	MIC:86
	Mr. Robert Lambert	MIC:82
	Ms. Jean Ogrod	MIC:82
	Ms. Janice Thurston	MIC:82
	Mr. Jefferson D. Vest	MIC:85
	Mr. Randy Ferris	MIC:82
	Ms. Mira Tonis	MIC:81
	Mr. David H. Levine	MIC:85

July 31, 2007

PROPOSED AMENDMENT

(f) INACTIVE PERMITS. A seller's permit may only be held by a person actively engaged in business as a seller of tangible personal property. The Board may revoke a seller's permit where it finds that the person holding the permit is not actively engaged in business as a seller of tangible personal property.

(1) Any person who holds a seller's permit but is not actively engaged in business as a seller of tangible personal property shall promptly surrender the permit by notifying the Board to cancel it.

(2) Except as explained in paragraph (3) of this subdivision, a person holding a seller's permit will be held liable for any taxes, interest, and penalties incurred, through the date on which the Board is notified to cancel the permit, by any other person who, with the permit holder's actual or constructive knowledge, uses the permit in any way. For example, a permit holder may be held liable for tax, interest, and penalty actually incurred by his or her transferee where the transferee displays the permit in his or her place of business, or uses the permit number on a resale certificate, or files sales and use tax returns under the permit number. The permit holder has the burden of establishing that the Board received notice to cancel the permit.

(A) The permit holder may notify the Board by delivering the actual seller's permit to the Board with the clear request that the permit be canceled. Where the reason for cancellation is that the permit holder transferred the business, the permit holder should identify the name and address of the transferee at the time the permit is surrendered to the Board. The permit holder may also notify the Board by delivering a written statement or email to the Board that the permit holder has transferred or otherwise ceased the business, or will do so at a specified time, and requesting that the permit be canceled. The statement should identify the name and address of the transferee, if any. The permit holder may also provide this notice to the Board orally, but it will be presumed that such notice was *not* provided unless the Board's records reflect that the permit holder clearly notified the Board of the cessation or transfer of the business for which the permit was held.

(B) The Board will also be regarded as having received notice of cancellation of the permit, and the permit holder will be excused from liability for the tax, interest, and penalty incurred by another person using the permit, as of the date the Board receives actual notice of transfer of the business for which the permit was issued. It will be presumed such notice was *not* received by the Board unless the Board's records reflect that the Board received a clear notice of the cessation or transfer of the business for which the permit was held. For example, the Board's receipt of an application for a seller's permit from the transferee constitutes sufficient notice if it contains adequate information to show that the application pertains to the same business for which the permit was held. Notice to another state agency of a transfer or cessation of a business

does *not* constitute notice to the Board. Rather, the Board must itself receive actual notice of the transfer or cessation of business.

(3) Where the permit holder does not establish that the Board received actual notice of the transfer of the business for which the permit was held and is thus liable for the taxes, interest, and penalties incurred by another person using that permit, that liability is limited to the quarter in which the business was transferred and the three subsequent quarters, and shall not include any penalties imposed on the other person for fraud or intent to evade the tax. However, these limitations (liability only for the quarter in which the business was transferred and the three subsequent quarters and no fraud or intent to evade penalty) do *not* apply where, after the transfer of the business, 80 percent or more of the real or ultimate ownership of that business is held by the permit holder. For these purposes, stockholders, bondholders, partners, or other persons holding an ownership interest in an entity are regarded as having the "real or ultimate ownership" of that entity.

CURRENT PROVISION

(f) INACTIVE PERMITS. A permit shall be held only by persons actively engaging in or conducting a business as a seller of tangible personal property. Any person not so engaged shall forthwith surrender his or her permit to the Board for cancellation. The Board may revoke the permit of a person found to be not actively engaged in or conducting a business as a seller of tangible personal property.

Upon discontinuing or transferring a business, a permit holder shall promptly notify the Board and deliver his or her permit to the Board for cancellation. To be acceptable, the notice of transfer or discontinuance of a business must be received in one of the following ways:

(1) Oral or written statement to a Board office or authorized representative, accompanied by delivery of the permit, or followed by delivery of the permit upon actual cessation of the business. The permit need not be delivered to the Board, if lost, destroyed or is unavailable for some other acceptable reason, but notice of cessation of business must be given.

(2) Receipt of the transferee or business successor's application for a seller's permit may serve to put the Board on notice of the transferor's cessation of business. Notice to another state agency of a transfer or cessation of business does not in itself constitute notice to the Board.

Unless the permit holder who transfers the business notifies the Board of the transfer, or delivers the permit to the Board for cancellation, he or she will be liable for taxes, interest and penalties (excluding penalties for fraud or intent to evade the tax) incurred by his or her transferee who with the permit holder's actual or constructive knowledge uses the permit in any way; e.g., by displaying the permit in transferee's place of business, issuing any resale certificates showing the number of the permit thereon, or filing returns in the name of the permit holder or his or her business name and under his or her permit number. Except in the case where, after the transfer, 80 percent or more of the real or ultimate ownership of the business transferred is held by the predecessor, the liability shall be limited to the quarter in which the business is transferred, and the three subsequent quarters.

Stockholders, bondholders, partners, or other persons holding an ownership interest in a corporation or other entity shall be regarded as having the "real or ultimate ownership" of the property of the corporation or other entity.