

M e m o r a n d u m

To : Mr. Ramon J. Hirsig
Executive Director (MIC 73)

Date: November 25, 2009

From : Randie L. Henry, Deputy Director
Sales and Use Tax Department (MIC 43)

Susan Buehler for Randie L. Henry

Subject : **Proposed Revisions to Compliance Policy and Procedures Manual Chapter 7, Collections.**

In accordance with the established procedures for audit and compliance manual revisions, I am submitting the following proposed revisions to Compliance Policy and Procedures Manual Chapter 7, *Collections*, for your approval to forward to the Board Proceedings Division. These changes have been reviewed and approved by SUTD management, provided to Board Members, and posted at http://www.boe.ca.gov/sutax/pdf/cpm07rev_pending.pdf on the Board's website to solicit comments from interested parties. We received no comments from the public.

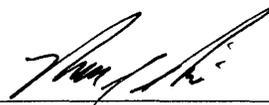
CPPM Chapter 7 revisions are proposed to incorporate into the CPPM new procedures for bankruptcies and other minor corrections in other sections of the chapter.

A summary and copies of the proposed revisions are attached for your reference. We request your approval to forward these proposed changes to the Board Proceedings Division for placement as a consent item on the Administrative Agenda for December 17, 2009.

If you have any questions, please let me know or contact Mr. Jeff McGuire at 324-1825.

RLH:dr
Attachment

Approved:



Ramon J. Hirsig
Executive Director

cc: (all without attachments)
Mr. Stephen Rudd (MIC 46)
Ms. Freda Orendt (MIC 47)
Mr. Jeff McGuire (MIC 92)
Mr. Kevin Hanks (MIC 49)
Ms. Kelly Reilly (MIC 47)
Ms. Erin Little (MIC 46)

Summary of new CPPM Chapter 7, *Collections*

The portion of CPPM Chapter 7, *Collections*, regarding bankruptcies was rewritten by the BOE legal staff to incorporate new procedures for processing taxpayer bankruptcies in IRIS and to update the terminology to conform to various revisions in the Bankruptcy Code. In addition, various minor revisions were made to other chapter 7 sections pursuant to Board Member request. The proposed chapter revisions are noted below:

Section 707.040 Included the addition of staff assistance in preparing the written claim for refund. Added text to include Property & Special Taxes programs.

Section 749.020 Reworded section 749.020 (3) to provide better direction to staff.

Section 764.070 Deleted reference to “willfulness and responsibility” in (6)(g).

Section 764.080 Added exclusion to term “responsible person” found in Reg. 1702.5. Added RTC before “section 6829” for conformity. Revised text in bullet number 6 to improve clarity. Eliminated terms “mere” and “gross” negligence as these terms are not defined. Restructured text of first 6 paragraphs in section 764.080 (Cont) to present the information in a more logical order.

Section 764.100 Reworded this section to present the information in a more logical order. Deleted #5 due to the absence of any statutory or regulatory source for the “fault” concept. Also, incorporated information from TPD memo dated 7/20/09.

Bankruptcy:

Section 740.010 Introduction was rewritten by Legal staff.

Section 740.020 New information for accessing bankruptcy information through the Pacer on-line bankruptcy information system.

Section 740.030 Incorporated Ops Memo 1134, BOE website and new information.

Section 740.040 Incorporated internal bankruptcy course material, new information, USBC 362.

Section 740.050 Moved and renumbered CPPM 754.102, added new information about the Bankruptcy Abuse Prevention and Consumer Protection Act.

Section 740.060 Ops Memo 1134, new information regarding claim preparation for pre-petition liability.

Summary of new CPPM Chapter 7, *Collections*

- Section 740.070** Moved and renumbered CPPM 754.055, new IRIS information regarding delinquent and split returns.
- Section 740.080** Moved and renumbered CPPM 754.040, new information about audit staff procedures when auditing on pre-petition liability.
- Section 740.090** RTC section 6829, Regulation 1702, new information regarding issuing dual determinations on pre-petition corporate liability.
- Section 740.100** CPPM 754.060, RTC sections 6701, 6815, new information about security deposit procedures.
- Section 740.110** CPPM 754.160, USBC sections 502, 507, new information about pre-petition claims in general.
- Section 740.120** CPPM 754.070, CPPM 754.110, CPPM 754.150, USBC sections 727, 523, new information about chapter 7 bankruptcy.
- Section 740.130** CPPM 754.120, CPPM 754.140, CPPM 754.110, USBC sections 1305, 1325, 1328, new information about chapter 13 bankruptcy.
- Section 740.140** CPPM 754.110, CPPM 754.120, CPPM 754.140, USBC sections 1129, 1141, new information about chapter 11 bankruptcy.
- Section 740.150** Incorporated new information about discharge review from Ops Memo 1134.
- Section 740.160** Added cite “In re Carlson” and “In re Isom”, incorporated new information about liens on discharged debt from Op Memo 1134.
- Section 740.170** USBC sections 503, 1305, new information about post-petition claims.
- Section 740.180** CPPM 754.155, Bus. & Prof. Code sections 24074, 24049, In re Farmer’s Market, BOE vs. Goggin, BOE vs. Sierra Summit.
- Section 740.190** USBC section 505.
- Section 740.200** CPPM 754.190, BOE website.
- Section 740.210** Ops Memo 1134, new information.
- Section 740.220** New information about bankruptcy payments.
- Section 740.230** CPPM 754.030, new information about bankruptcy in IRIS.
- Section 740.240** New information about bankruptcy in ACMS.

Summary of new CPPM Chapter 7, *Collections*

Section 740.250 Rewritten by legal counsel.

Section 740.260 RTC sections 6757, 7053, and 7054, CCP sections 1204-1206, 1800, and 1802, Civil Code section 1954.1, new information regarding assignments for benefit of creditors.

Section 740.270 Probate Code (in general) and specifically sections 11420, 9760, 9201, 9203, RTC section 6487.1.

Section 740.280 CCP sections 1204-1206, 564, RTC section 6756.

New material:

Source: Neil Shah, advisor to Board Member Steel.

Revised: Suggested the addition of staff assistance in preparing the written claim for refund.

REFUNDS OF EXCESS OR ERRONEOUS AMOUNTS RECEIVED

707.040

The BOE may receive funds from an enforced collection action that are in excess of the liability due because the funds are determined to be remitted in error or otherwise not due. Such instances include, but are not limited to:

1. Funds from an escrow for an account where the liability was paid, but a release of lien was not recorded.
2. Amounts billed, such as a successor or predecessor liability, innocent partner or spouse, which are determined not to be due.
3. Funds not subject to or exempt from levy, such as amounts over the maximum allowed by law for a wage garnishment.

In such cases, collection staff should offer to assist the taxpayers may in obtaining and completing the necessary forms to file a written claim for refund. When a taxpayer files a claim for refund with the district office or headquarters office for funds that have been paid to the BOE with regards to a sales and use tax account, the taxpayer's written refund request must be sent to the Audit Determination and Refund Section in Headquarters. The request must be accompanied by the District Principal Compliance Supervisor's recommendation to either approve or deny the refund claim. A claim for refund involving Property and Special Taxes Department-administered programs should be sent to the Audit section of the appropriate division.

Period Within Which to Establish Successor's Liability**732.120**

A notice of "successor's liability" billing may be issued no later than three years after the BOE is notified in writing of the purchase of the business or stock of goods. However, ~~the~~ statute of limitations for issuing the notice of successor's liability does not begin to run until the BOE has been notified in writing of the purchase of the business. If there is no notification, there is no statute of limitation, assuming there was a timely billing to the predecessor under RTC section 6487.

Once a notice of successor's liability becomes final, collection from the successor may be enforced using all collection actions. Active collection action may be used at any time within ten years after the finality date of the liability. The period may be extended by recording a Notice of State Tax Lien or abstract against the successor in any county before the expiration of the ten-year period and may be further extended by a new recording before the expiration of ten years from the date of the original recording.

New material:

Source: Board Member Leonard's staff

Revised: Reworded section 749.020 (3) to provide better direction to staff.

FIELD CALLS

749.000

GENERAL

749.010

For compliance purposes, there are seven primary reasons to make a field call:

1. To reinstate an account after revocation of the permit or license.
2. To obtain payment and/or delinquent tax returns.
3. To verify that the business is operating or closed.
4. To gather collection and skip-tracing leads.
5. To gather evidence for prosecution.
6. To maintain a physical presence in the business community.
7. To conduct certain non-collection related activities, such as permit inspections pertaining to swap meets.

In addition to the seven reasons above, there are other reasons to make field calls such as witnessing the destruction of alcoholic beverages or conducting an investigation for city or county annexation purposes (an annexation investigation may be necessary when a city or county incorporates territory into its existing geographic area. When this occurs, the businesses within that area will need to have the tax area code changed.) Although the majority of compliance field calls are oriented toward reinstating accounts and collecting money, all field calls require advance planning and should never occur without proper preparation.

Before making a field call, the collector should have a plan of action and be completely familiar with the taxpayer's account information, ACMS history, and the requirements the taxpayer must meet in order to reinstate the permit or license, if a revocation exists. In addition, the collector should be prepared to collect all amounts owed by the taxpayer, obtain all tax returns that are due from the taxpayer, and provide the taxpayer with all the necessary documents to complete the assignment.

For each field call, the collector should have a primary plan and some contingency plans. For example, a field call reveals that the business location is vacant. In this case, the primary plan to reinstate the taxpayer's account must be altered and the contingency of talking to the nearby business neighbors, visiting the taxpayer's home address, contacting the landlord, or another alternative plan put into action.

The collector will normally schedule a number of field calls on the same day and should map out the business locations to be visited. Clustering the field calls together allows the collector to minimize travel time. Mapping requires the use of a Thomas Guide map book or similar resource, such as MapQuest. If the vehicle taken to the field is equipped with an onboard navigation system, the route to the various businesses can be preprogrammed to provide the most economical route.

CONDUCTING FIELD CALLS

749.020

The following tips will help to insure successful field calls:

- 1) Present yourself professionally by dressing and behaving professionally. By doing so, you demonstrate that you take your position as a representative of the ~~Board of Equalization~~ BOE seriously and create an atmosphere of respect and credibility with the taxpayer.
- 2) Before leaving the office, you must know your reason(s) for meeting with the taxpayer, have reviewed the case history, mapped out your route, and ensured that you have all the information necessary to complete your assignment. Some recommended items to bring with you on a field call include:
 - a. State of California identification card and business cards.
 - b. Receipt book.
 - c. Cell phone.
 - d. Copy of the revocation notice.
 - e. Extra tax return forms.
 - f. Applications for the taxpayer to obtain a permit or license.
 - g. Pertinent regulations or publications.
 - h. Envelopes, notepad, and tape (for taping notices to the door when necessary).
 - i. Calculator.
 - j. Thomas Guide or similar map book.
 - k. Coins for parking meters.
 - l. BOE-945, *Receipt for Books and Records of Account*.
 - m. Counterfeit bill detection pen.
 - n. Security deposit documents
- 3) ~~Do not return to the office empty handed. Secure~~ Obtain all tax returns, payments, or other information that will clear your assignment. If this cannot be accomplished during the field call, document the attempt to obtain this information and take appropriate action to prompt a response from the taxpayer, or to clear the assignment.
- 4) While in the field, safeguard the security of all ~~Board of Equalization~~ BOE property, including equipment, work papers, receipt books and payments.
- 5) Upon returning to the office, complete Form BOE-609, *Tax Representative Daily Report*.

FIELD CALLS – SPECIAL EVENTS

749.030

RTC section 6073 provides that the Board of Equalization BOE may:

1. Require the operator of a swap meet, flea market, or special event to verify that any person desiring to engage in or conduct business as a seller on premises owned or operated by the operator holds a valid seller's permit.
2. Obtain a written statement from any seller not holding a seller's permit that he or she is not offering for sale any item the sale of which is subject to sales or use tax or that he or she is otherwise not required to hold a valid seller's permit.
3. No more than three times a year, require an operator to submit a list of vendors conducting business on its premises as a seller.
4. Impose a fine not to exceed \$1,000 for each offense on any operator of a swap meet, flea market or special event who refuses or fails to comply with the provisions of RTC section 6073.

It is often desirable to conduct a "permit inspection" of these types of special events. Prior to making a field call for this purpose, the collector should:

1. Contact the event operator and obtain a list of event participants and the booth or space number for each participant.
2. Check the names of the participants against registration information in IRIS and verify that the permit is valid, active and in good standing.
3. Identify the participants who do not hold a valid seller's permit and return the list to the event operator. Advise the operator that the identified participants will need to meet with you prior to opening their booth on the first day of the special event.
4. Make a field call to the special event on the first day to obtain compliance from those participants who did not resolve the situation prior to the start of the event.

New Material:

Source: Neil Shah, advisor to Board Member Steel

Revised: 764.070: Deleted reference to “willfulness and responsibility” in (6)(g).

**PROCEDURES TO ESTABLISH A
CORPORATE SUSPENSION DUAL DETERMINATION**

764.070

A corporate suspension dual may be established even if the seller’s permit is still active. Complete each of the following steps before submitting a request for a dual determination to ADRS:

1. Establish that the corporation has been/was suspended by accessing Secretary of State corporate information via ACMS. Relevant information that can be obtained through the Secretary of State includes FTB filing history, the Federal Employer Identification Number (FEIN), the Corporate Number, the date of incorporation, the date of suspension (if any) and the filing and payment history for the corporation’s income taxes.
2. Establish that the statute of limitations has not expired for the liability in question.
3. Establish that the liability to be assessed against the corporate officers was incurred by the corporation during the suspension period.
4. Establish that the corporation is a closely held corporation by showing that:

1.a. The ownership is concentrated in one person, a family, or a small group of individuals.

2.b. The majority stockholders also managed the business.

3.c. The corporate minutes are inadequate.

5. Establish that the corporation received tax reimbursement. This can be determined in a number of ways:

1.a. Review previous sales tax returns for line 9 entries (sales tax included on line 1). Copies of prior tax returns can be ordered from the Taxpayer Records Unit if necessary, or the information can be printed from REV FZ in IRIS.

2.b. Review the audit comments on previous audits, including Form BOE-1296, *Account Update Information*.

3.c. Send a Form BOE-1508, *Dual Determination Information Request (Officer)* (available in ACMS) to each of the former corporate officers. A current statement of corporate officers can be obtained from the Secretary of State.

4.d. Send Form BOE-1509, *Dual Determination Information Request (Employee)*, (available in ACMS) to a few ex-employees of the corporation. A list of employees can be obtained from an external access request for payroll tax return data reported to EDD.

**PROCEDURES TO ESTABLISH A
CORPORATE SUSPENSION DUAL DETERMINATION**

(CONT.) 764.070

a.e. Send a Form BOE-1510, *Dual Determination – Customer Affidavit*, (available in ACMS) to any previous customers of the corporation. Customers can be found from previous audits, bankruptcy mailing matrices or contact with ex-employees.

If investigation does not reveal whether or not sales tax reimbursement was collected on the transaction for which the tax was due, a dual determination may be issued against the corporate officers only if there is evidence showing that the corporation's normal operating procedure was to include or add sales tax reimbursement. If it is known, or there is a strong presumption as in the case of disallowed deductions, that sales tax reimbursement was not collected, we should not include such sales in the dual determination. Transactions included under the "normal operating procedure" rationale that are later discovered not to include tax reimbursement must be deleted from the determination.

6. Ascertain the responsible individual who is charged with the filing and paying of taxes and other liabilities, or supervision of such employees, by:
 - a. Reviewing the information in the file and in collection notes.
 - b. Contacting ex-employees of the corporation and asking them to complete a Form BOE-1509.
 - c. Contacting responsible corporate officers and other corporate officers and asking them to voluntarily complete a Form BOE-1508.
 - d. Checking audit comments for any mention of responsible corporate officers, including form BOE-1296.
 - e. Checking previous sales tax returns and ordering corporate income tax returns.
 - f. Checking copies of previous checks used to pay sales tax returns for signatures.
 - g. If the corporation filed bankruptcy, checking the bankruptcy court file for a "*Statement of Financial Affairs*." This statement can provide a wealth of information including ~~willfulness and responsibility.~~ It will include references to payments to corporate officers and major creditors in the period prior to the bankruptcy petition, and it is signed under penalty of perjury by the responsible officer.
 - h. Considering a subpoena of bank records to determine who signed checks. This tool is effective, but it is costly and time consuming. Given the added expense of a subpoena, other elements of the dual should be verified first.
7. Prepare an interoffice memorandum requesting a corporate officer dual determination and send it to ADRS along with documentation of the above items.

New Material:

Source: M. Pennington & L. Williams, Board Member Leonard's staff.

Revised: 764.080, 764.100 to address suggestions made by L. Williams.

DUAL DETERMINATIONS UNDER RTC SECTION 6829

764.080

RTC section 6829 provides the BOE with an avenue to issue dual determinations against any responsible officer, member, manager or partner (hereinafter called "responsible person") who willfully failed to pay the taxes which were collected for a corporation, limited liability partnership or a limited liability company (hereinafter called "entity".) Regulation 1702.5 specifically states the term "responsible person" does not include any person who would otherwise qualify but is serving in that capacity as an unpaid volunteer for a non-profit corporation.

To establish a dual determination under RTC section 6829, the following elements must be satisfied:

1. The entity must be terminated, dissolved or abandoned. "Termination" also includes the discontinuance or cessation of business activities. If a sub-location of a consolidated account closes out, has a liability, and the entity does not clear the liability, the responsible individuals(s) of the sub-location or the continuing entity may be billed.
2. The person(s) being held liable for the unpaid taxes must have had the control or supervision of, or be charged with the responsibility to file returns, pay the sales and use taxes or the duty to act for the entity in complying with any requirement of this section.
3. A parent corporation may have the control, and responsibility, ~~etc~~ for filing sales and use tax returns for a subsidiary or subsidiaries. In this case, the parent corporation is billed rather than the officers of the parent corporation.
4. The liability to be determined against any responsible person must have been incurred by the entity during the period that person was actually supervising or in control of filing tax returns and/or making payment for the entity.
- ~~4.5.~~ It must be established that sales tax reimbursement was included in or added to the selling price of the tangible personal property sold or that the entity consumed tangible personal property and failed to pay the use tax. (See CPPM 764.060).
6. The responsible person(s) will be regarded to have willfully failed, or willfully caused the failure, to pay or to pay any sales and use taxes due from the entity when the failure was the result of an intentional, conscious, and voluntary course of action (see CPPM 764.100). The term "intentional, conscious, and voluntary course of action" may include any of the following:
 - a. Cases in which there are frequent errors in computing and reporting tax. Note: "Intentional, conscious and voluntary acts" do not include infrequent or minor clerical errors in reporting the tax ~~or mere negligence as opposed to gross negligence.~~
 - b. Cases where the responsible persons have been notified of correct procedures or requirements for reporting and paying tax, but have subsequently failed to correct the reporting procedures.
 - c. Assessments involving errors where negligence or evasive penalties have been applied.
 - d. Situations where a prudent business person would have reported and paid the tax.

DUAL DETERMINATIONS UNDER RTC SECTION 6829

(CONT.) 764.080

Tax money collected, but not remitted, may have been used to benefit the responsible party or other corporate shareholders or officers. However, having an ownership interest in the corporation and/or gaining any direct financial benefit from failing to pay the corporation's taxes is not necessarily indicative of personal liability under RTC section 6829.

The key to asserting personal liability under RTC section 6829 lies in determining who had the actual duty and responsibility to report and pay the sales and use taxes within the day-to-day operation of the corporation. RTC section 6829 does not impose liability on persons who have control over the corporate affairs in general, but imposes liability only on those persons who had control, supervision, responsibility or the duty to act for the corporation in sales and use tax matters. A dual determination cannot be issued against a corporate officer simply because he or she was the holder of a corporate office.

~~As an~~For example, even though a president of a corporation generally possesses overall or primary responsibility for the operation of the corporation, the holding of that office does not preclude a ~~delegation~~separation of duties and the power to perform those duties so that another individual could be the responsible person. ~~RTC section 6829 does not impose liability on persons who have control over the corporate affairs in general, but imposes liability only on those persons who had control, supervision, responsibility or the duty to act for the corporation in sales and use tax matters.~~

Consequently, it must be determined who the person(s) were that possessed actual operational control over the corporation's finances or, more specifically, tax matters.

This person may be the one who owns the controlling interest in the corporation or somebody else, such as a "chief financial officer," "general manager," or any other similarly titled person hired for this purpose, given the authority to so act, and who may have assured the officers and the Board of Directors of the corporation that the taxes were current or somebody else, such as a "chief financial officer," "general manager," or any other similarly titled person hired for this purpose, given the authority to so act, and who may have assured the officers and the Board of Directors of the corporation that the taxes were current. More often than not, this person, if he or she is actively involved in the business, would have had a great deal of say as to who was or was not paid.

~~Tax money collected, but not remitted, may have been used to benefit the responsible party or other corporate shareholders or officers. However, having an ownership interest in the corporation and/or gaining any direct financial benefit from failing to pay the corporation's taxes is not the entire key to personal liability under RTC section 6829. The key to asserting personal liability under RTC section 6829 lies in determining who had the actual duty and responsibility to report and pay the sales and use taxes within the day-to-day operation of the corporation. This could be a "chief financial officer", "general manager", or any other similarly titled person hired for this purpose, given the authority to so act, and who may have assured the officers and the Board of Directors of the corporation that the taxes were current.~~

Corporate minutes, by-laws, books and records, Secretary of State records (statement of officers and articles of incorporation), Department of Corporations records (applications for permit to issue stock, notification of stock issuance, and principal stockholders), bank records, U.C.C. financing statements, corporate income tax returns, prior audits and field investigation reports are just some of the sources of information available to assist in determining who was actually responsible for the corporation's failure to pay its taxes. These records, however, may not be conclusive in and of

themselves and this is why an in-depth investigation should include a personal interview with at least one person knowledgeable about the day-to-day operations of the corporation. ~~Nothing precludes d~~Discussing the available documentation available with a potentially responsible person ~~to be dualled and gaining his or her~~ obtaining the input of a potential "responsible person" who may be under consideration to receive a dual determination is encouraged. Any feedback obtained from ~~the~~ such person will tend to indicate the point or points of disagreement and the those areas that ~~needs to have~~ require the strongest evidence available.

These guidelines are to be considered when a final determination issued against a corporate officer is being worked for collection. If, in the opinion of the district office staff, the facts of the particular case did not warrant issuing a dual determination, the supervisor of ADRS is to be notified to cancel the liability.

DEFINITION OF WILLFULNESS

764.100

Under RTC section 6829(d), "willfully fails to pay or to cause to be paid" means that the failure was the result of an intentional, conscious and voluntary course of action. ~~Willfulness depends upon the facts and circumstances of each case. Rarely, if ever, will~~ Except in rare cases where an earlier audit or investigation has already supplied the necessary information, the facts and circumstances of a particular case generally cannot be ascertained from a review of the file and. Generally, an in-depth investigation must be made conducted. During ~~this~~ the investigation, a personal interview with at least one person having direct, personal knowledge of the inner workings of the entity is strongly recommended. ~~Only in those rare cases in which an earlier audit or other in-depth investigation has already supplied the necessary facts and circumstances will the preceding not be needed.~~ It should be noted that RTC section 6829 does not make the corporate officers or other responsible persons the guarantors of the entity's taxes.

~~An interoffice memorandum summarizing the facts and circumstances in existence upon conclusion of the investigation into willfulness must be completed and sent to ADRS. The following list contains six techniques to aid staff in the identification of willfulness but since willfulness may be established in a variety of ways, the list is not exhaustive.~~

Since evidence of willfulness may be noted in a variety of ways, the following list is not exhaustive, but staff should consider the following five areas when attempting to identify willfulness:

1. The investigation must show evidence of the availability of funds from which the tax payment could have been made, but was not. In other words, the entity must be shown to have had money before one could say the responsible person willfully failed to pay. On the other hand, an entity, which has had cash and other liquid assets seized or levied upon by creditors, cannot be said to have had available funds. Further it cannot be assumed, simply because there is evidence of sales tax reimbursement, that the money was available when the taxes became due and payable.
2. The holding of a corporate office, in and of itself, is not grounds for holding a corporate officer personally liable. ~~Whether or not this guideline overlaps into the responsibility or responsible person issue is important to consider here. RTC section 6829 is meant to cut through the organizational form of the corporation or other type of entity and impose liability upon those persons actually responsible for the entity's failure to pay its taxes. This requires looking through the mechanical functions of the various corporate officers or other persons to determine the person(s) having the actual power to control the decision-making process by which the entity allocated funds to other creditors in preference to its tax obligations. The mechanical duties of signing checks and preparing tax returns are not determinative.~~
3. A showing of fraud or an intent to evade the taxes is not necessary in order to establish the element of willfulness. Nor does a finding of willfulness entail a showing of evil motive, bad purpose, or calculated malevolence. Rather, the focus of the investigation should be on the intentional nature of the individual's election not to pay over the taxes and the ~~conditions~~ facts and circumstances under which the election was made, i.e., the facts and circumstances.
4. ~~Mere negligence alone is may not be sufficient for a finding of willfulness. This is particularly true when the negligence occurs as to the application of the sales tax to specific transactions. The old adage "everyone is presumed to know the law" cannot be used to find willfulness. Willful, as a voluntary act, is to do a thing knowingly, after indulging in a mental process, as opposed to oversight, simple neglect, or inadvertence. Accordingly, infrequent or minor clerical errors in reporting or paying the tax will not support willfulness.~~

5. At some point, however, mere negligence could overlap into gross negligence or become a reckless disregard of an obvious and known risk that taxes might not be properly remitted, thereby sustaining willfulness. This could occur where the For example, if the responsible person(s) have been notified of correct procedures or requirements for reporting and paying tax but have subsequently failed to correct the reporting procedures.
5. ~~There must be an element of personal fault of the responsible person after considering all of the facts and circumstances. If the responsible person acted in good faith as to taxes, no personal liability attaches. The fact is there are constantly cases of business failures in which taxes are not paid through no fault of the person(s) responsible for the entity's taxes. RTC section 6829 does not make the corporate officers or other responsible persons the guarantors of the entity's taxes nor does it impose an absolute duty to pay the entity's taxes on responsible persons.~~
6. ~~The investigation must show evidence of the availability of funds from which the tax payment could have been made but was not. In other words, the entity must be shown to have had money before one could say the responsible person willfully failed to pay. On the other hand, an entity, which has had cash and other liquid assets seized or levied upon by creditors, cannot be said to have had available funds. Further, we cannot assume, simply because there is evidence of sales tax reimbursement, the moneys were available when the taxes became due and payable.~~

An interoffice memorandum summarizing the facts and circumstances in existence upon conclusion of the investigation into willfulness must be completed and sent to ADRS.

New material: Introduction, Accessing BXI information through the Pacer system, Op Memo 1134 into 740.030, 740.150, 740.160 and 740.210, BAPCPA into 740.050, IRIS info into 740.070, Auditing pre-petition liabilities into 740.080, Dual Determinations into 740.090, Security Deposits into 740.100, Pre-petition claims into 740.110, new chpt 7 info into 740.120, new chpt 13 info into 740.130, new chpt 11 info into 740.140, post-petition claims into 740.170,
Source: Legal Dept, Special Procedures staff and other subject experts, Op Memo 1134, U.S. Bankruptcy Code, Rev. & Tax. Code, Code of Civil Procedure, Probate Code
Changed: Section 754.000 moved to Section 740.000 to improve chapter sequencing.

Bankruptcies, Assignments, for the Benefit of Creditors, Receiverships, and Probates 754.000740.000

BANKRUPTCY – IN GENERAL 754.010740.010

~~To receive payments from the assets available in bankruptcy, assignment, receivership, and probate estates, formal claims must be filed by all creditors including taxing agencies. Claims for taxes that are filed against estates have priority over certain other claims. Therefore, when a taxpayer becomes involved in one or more of these types of proceedings and owes a liability, a claim should be filed in the estate. If through error no claim is filed, collection in most cases will be difficult or impossible.~~

~~District offices have the ultimate responsibility for discovering legal proceedings involving taxpayers that are required to have an account with the Board. This information may be obtained from various publications that furnish this type of information. The information might also be obtained from the taxpayer, business associates, other creditors, or through other informal sources.~~

~~All formal claims, where collection of the tax is the responsibility of the Board, are prepared and filed by the Headquarters Special Procedures Section based upon information furnished by the district office. Generally, claims for tax and pre-petition interest over \$500 will be filed in any proceeding. The Headquarters Special Procedures Section is responsible for following these claims, with the assistance and cooperation of the district offices. The Headquarters Special Procedures Section will notify the districts when to proceed with collection action.~~

~~Preparation, filing and follow-up of all formal claims for gasoline (motor vehicle fuel) taxes are the responsibility of the State Controller.~~

Bankruptcy is a system of federal laws, rules, and procedures pursuant to which persons and entities may submit their assets, liabilities and financial affairs to the jurisdiction of the United States bankruptcy courts. Bankruptcy often involves the interplay of both federal bankruptcy law and state law. The Bankruptcy Reform act of 1978 created the Bankruptcy Code, which became effective in October 1979. The Bankruptcy Code contains the federal statutes that provide the substantive law for all bankruptcy cases. The Federal Rules of Bankruptcy Procedure govern bankruptcy procedures, administration, and litigation. Bankruptcy case law interprets the statutes and rules under the specific facts of a case and provides legal precedents for cases with similar facts.

The Board of Equalization (BOE) is prohibited from collecting from a tax debtor outside of bankruptcy when a tax or fee is discharged in a bankruptcy case. If a debtor has a liability that is excepted from the bankruptcy discharge, creditors may continue to take collection action against the debtor, since the debtor is no longer protected by the automatic stay provided by filing bankruptcy. When a debtor has a current or potential unpaid tax or fee liability to the BOE, the Bankruptcy Team in the Special Procedures Section (SPS) should review the bankruptcy case to determine whether the BOE has a right to receive a distribution from a bankruptcy estate and to collect from a debtor. If so, the Bankruptcy Team should take appropriate action to protect the BOE's right to receive a distribution from the bankruptcy estate and to collect from a debtor outside the bankruptcy case.

Ordinarily, to receive distributions in bankruptcy cases, creditors, including tax agencies, must file proofs of claim. The Bankruptcy Team monitors the status of bankruptcy cases, files proofs of claim, and collects liabilities for accounts in bankruptcy. Once a case exits bankruptcy, the Bankruptcy Team will remove it from legal status, and, if a liability remains collectible, return collection responsibilities to the district office.

GLOSSARY OF BANKRUPTCY TERMS

754.020

TERM	DEFINITION
Assets Abandoned by Trustee	The trustee in bankruptcy may decide not to include certain assets of the bankrupt as part of the bankruptcy estate. For example, the debtor may not have sufficient equity in certain property to make inclusion of the property in the estate worthwhile. The trustee would then petition the court for abandonment of the assets and, if approved, they are released from the estate.
Automatic Stay	General protection from any form of collection activity instituted at the time the bankruptcy petition is filed. Collection action is stopped or "stayed" as an operation of law.
Bar Date	The date by which a claim must be filed.
Case Closed	Administration of the bankruptcy estate is complete and the case is closed.
Chapter 7	Liquidation
Chapter 9	Reorganization (Municipality).
Chapter 11	Reorganization
Chapter 12	Adjustment of Debts of a Family Farmer with Regular Annual Income.
Chapter 13	Adjustment of Debts of an Individual with Regular Income.
Claims in Bankruptcy	Notification to the courts of amounts owed by the debtor.
Confirmed Plan of Reorganization	Court ordered plan that generally reverts all assets of the Estate to reorganized court.
Date of Order of Relief	The date of filing of any voluntary petition that operates as the decree date of a bankruptcy court.
Debtor	The subject of a bankruptcy case.
Debtor in Possession	A taxpayer who remains in control of his/her business or assets during a Chapter 11 or Chapter 13 case. A Debtor in Possession has the same power and authority as a court appointed trustee.

Discharge	The release of a debtor from all of his/her dischargeable debts in bankruptcy (See Section 754.150). The act whereby certain debts are forever forgiven.
Dismissal	Equivalent of a cancellation. Places the parties in the same condition as if no bankruptcy had been made.
Dividend	Monies received from the bankruptcy estate as a result of a claim.
Expense of Administration Claims	A claim filed in a bankruptcy proceeding having a higher priority than a proof of priority claim for tax liability incurred during the administration of the estate.
Gap Period Claim	A creditor's claim that arises in an involuntary case in the ordinary course of the debtor's business after the petition is filed but prior to the appointment of a trustee and the order for relief.
Involuntary Bankruptcy	<p>A petition filed by creditors seeking an order for when:</p> <ul style="list-style-type: none"> -1. The debtor is generally not paying its debts as they mature, or -2. A custodian was appointed or took possession during the 120-day period preceding the filing of the petition. (If a custodian of all or substantially of the property of the debtor has been appointed, the debtor's creditors have an absolute right to have the liquidation proceed in the bankruptcy court. <p>Three or more creditors must file a petition. The amount owed to all of them must aggregate \$10,000 more than the value of any lien securing their claims unless all creditors total less than 12, in which case, one or more creditors may file petition provided the claim or claims total \$10,000 or more. The Bankruptcy Reform Act of 1994 increased the amounts necessary to commence an involuntary case against the debtor from \$5,000 to \$10,000. Section 303 of the Bankruptcy Code covers involuntary bankruptcies and should be referred to when dealing with these types of cases. When the situation involving an involuntary case arises, Section 303(b) becomes very important. This section says in part "...except to the extent that the court orders otherwise, and until an order for relief in the case, any business of the debtor may</p>

continue to operate, and the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced." When dealing with an involuntary petition for a Chapter 7 Case, complete the legal claim case screen and transmit to Special Procedures. Enter B17 in the type field.

No-Asset Case

Chapter 7 cases where assets may exist but there are no assets available for distribution to the creditors. In these cases, the assets only pay the expenses of the case (trustee, attorney, etc.).

Order for Relief

A determination, whether by decree or by operation of law, that a person is a bankrupt.

Petition

A pleading that commences a case under the Bankruptcy Code.

Plan of Reorganization (Chapter 11)

Any plan for settlement, satisfaction, or extension of the time of payment of the debtor's unsecured debts upon any terms.

Priority of Claims

2. Gap Period Claims.

3. Wages and commissions not exceeding \$,4000 earned within 90 days prior to petition.

4. Certain contributions to employee benefit plans arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first.

5. Certain claims of producers of grain and U.S. fishermen

6. Consumer creditors who have paid money for the purchase or rental of property or a service that has not been delivered, not to exceed \$1,800 for each individual.

7. Allowed claims for alimony

8. Allowed unsecured claims for taxes legally due and owing the United States, any state or subdivision thereof.

The Bankruptcy Reform Act of 1994 made several amendments to section 507 of the Bankruptcy Code. Wages and commissions

were increased from \$2,000 to \$4,000. Consumer creditors claims were increased from \$900 to \$1,800. A new priority claim for alimony and child support was created and given priority 7. This change reduced allowed unsecured claims for taxes to priority 8.

Trustee in Bankruptcy

Court officer appointed by the court who assumes control of all assets of debtor and administers the estate. Sometimes the trustee will personally operate the business when this is practical to conservation of assets (see Section 754.155 concerning need for a permit).

Voluntary Bankruptcy

Taxpayer files petition.

PACER

740.020

There are thirteen Bankruptcy Courts in California, spread among four districts: Southern (San Diego area), Central (Los Angeles area), Northern (Bay Area), and Eastern (Fresno/Sacramento/Central Valley areas). Although many of the BOE's tax debtors file bankruptcy in California, cases affecting the BOE's tax debtors may be filed in bankruptcy courts throughout the country.

The court dockets of cases filed in these courts and most legal papers filed in these cases can be accessed using the PACER System (Public Access to Court Electronic Records). PACER is accessible via eBOE or through the internet at: <http://pacer.psc.uscourts.gov/psco/cgi-bin/links.pl>. The BOE has a general username and password used by the entire agency. This information is available through the responsible supervisor.

The U.S. Party/Case Index serves as a locator index for PACER. The U.S. Party/Case Index is a national index for U.S. district, bankruptcy, and appellate courts that searches the entire nation's bankruptcy filings by name, social security or case number.

PACER can also be used as a collection tool since it can be used as support for issuing dual determinations and successor liabilities.

NOTIFICATION TO SPECIAL PROCEDURES – LEGAL CASES

754.030

IDENTIFICATION OF BANKRUPTCY STATUS

740.030

Promptly upon learning the estate of a taxpayer is involved in bankruptcy, assignment for benefit of creditors, probate, or receivership proceedings, the district office will obtain the required information and complete the legal claim case screen on-line. This screen is to be used for all taxes administered by the Board. Care must be taken to ensure all required information is entered on this screen.

In bankruptcy cases, the information can generally be obtained from the trustee, records of the bankruptcy court, or the attorney for the debtor.

In probate and receivership cases, complete information can be obtained from the court records available in the county in which the estate is being administered.

In cases of general assignments for the benefit of creditors, information can be obtained from the assignee, from the debtor's attorney, or the debtor. The only information other than the general information required in all legal cases is the name and address of the assignee and the date of the assignment. Frequently, if information is not complete from the original source, the remaining information can be obtained through a telephone call to appropriate offices or persons, thereby making time-consuming field assignments unnecessary.

The legal claim case screen should be prepared for Chapter 7 cases even if the court has indicated the case is a no-asset case. However, the district must insure that the 'Y' indicator is entered in the No Asset Case field in the legal claim case screen to prevent erroneous claims being filed.

Bankruptcy notices are sent to the Registration and Security Control Team in LRAS by the eleven California courts. The Registration and Security Control Team in LRAS will screen these bankruptcy notices on a priority basis, including notices of conversion from one chapter to another. All notices indicating assets or the probability the debtor holds a permit with the Board will be searched for account numbers. Notices developing a permit number will be sent to the district for their immediate action. The legal claim case screen, including BAR DATE, if available, will be completed and transmitted by the district to Headquarters Special Procedures Section as quickly as possible so a legal follow up may be established on the account. This follow-up will generally set a date one month prior to the last date (the Bar Date) a claim can be filed. Headquarters Special Procedures Section will review the account and cause a claim to be prepared for filing in the debtor's estate.

Districts must have all delinquencies cleared, audits completed, and the figures made available to Headquarters Special Procedures Section not less than 30 days before the final date to file claims (Bar Date). If delinquent returns are received within six (6) weeks of the Bar Date, a copy of each return must be sent directly to the Headquarters Special Procedures Section after the appropriate "NR" or "PR" comments have been entered.

No follow-up will be made by Headquarters Special Procedures Section regarding clearance of delinquencies, completion of audits, etc. The acceleration of time in which to file claims precludes such inquiry.

General notice that a bankruptcy case is commencing may come from many different sources such as actual written notice, verbal notice from a taxpayer, attorney or trustee, a search in PACER, or the news. After receiving notification and verifying that a bankruptcy case has

commenced, the bankruptcy information should be entered into the IRIS legal subsystem if the BOE has either a current interest (current liability due or active account) or future interest (potential liability due) in the case.

Either PACER information or an actual written notice of a taxpayer's bankruptcy is required in order to update accounts in IRIS with the legal status indicator flag ("lg").

For sales and use tax accounts, the district offices, headquarters sections, Centralized Collection Section (CCS), and SPS collectively are responsible for designating bankruptcy legal status for accounts in IRIS. Also, the Property and Special Taxes Department (PSTD) collection staff and SPS are collectively responsible for designating bankruptcy status for PSTD accounts in IRIS. Sales and Use Tax Department (SUTD) and PSTD staff should enter the bankruptcy information into the IRIS legal subsystem when:

1. A notice regarding the commencement of a bankruptcy case is sent directly to a BOE district office.
2. Collection staff is made aware of a bankruptcy filing by a taxpayer or the taxpayer's representative and verifies the filing with the court.
3. Staff becomes aware of an immediate deadline in a bankruptcy case. If such a deadline occurs, SPS must be notified without delay after entering the bankruptcy information.

When a notice regarding commencement of a bankruptcy case is sent directly to the headquarters office of the BOE, SPS will enter the bankruptcy information into the IRIS legal subsystem. SPS does not forward the bankruptcy notice to the districts, CCS, or divisions within PSTD.

All other bankruptcy related notices received by SUTD district offices, CCS, or divisions within PSTD should be sent to SPS (MIC 55). See CPPM 740.230 regarding procedures for inputting information into the legal subsystem.

In the California bankruptcy court registries, the BOE has designated the following address to be used for notification of all general bankruptcy matters: California State Board of Equalization, Account Information Group, MIC 29, P.O. Box 942879, Sacramento CA 94279-0029.

PROCEDURE WHEN AUDIT IS TO BE MADE – LEGAL CASES **754.040**
AUTOMATIC STAY **740.040**

USBC §362

~~In all cases where an audit is intended, the Audit Approval section of the legal claim case screen must be completed. Once completed, the legal claim case screen will be transmitted to the Headquarters Special Procedures Section promptly so a proper control can be established for the timely filing of a claim. When referring a case to the audit section, a notation should be made that the deadline for the receipt of the audit in headquarters is one month prior to the Bar Date. For bankruptcy petitions filed on or after October 22, 1994, it is not a violation of the automatic stay for the Board, or any other governmental unit, to conduct an audit to determine a tax liability.~~

~~In all cases where an audit is to be made, it is important to determine the location of the records. This will expedite the audit process in as much as the auditor will not have to locate the books~~

and records. The person who has possession of the records should also be notified whether or not an audit is intended.

United States Bankruptcy Code §362 places a “stay” (stop order) on most collection activity starting the moment the debtor files bankruptcy. Most collection efforts **must** be immediately released, removed and/or stopped from that date until the automatic stay and the discharge injunction no longer restrain the BOE’s collection actions.

BOE collection actions prohibited by the automatic stay include:

1. Revocation of a seller's permit.
2. Supplier cut off letters.
3. Liens.
4. Levies or withholds.
5. Warrants (including keepers, till taps, and seize and sells).
6. Demands for payment (including demand notices).
7. FTB, EDD and other offsets.
8. Suspension of Liquor License.
9. Earnings Withholding Orders for Taxes (wage garnishments).

BOE actions that are not prohibited by the automatic stay include:

1. Demands for tax returns to be filed.
2. Assessments including compliance assessments, field billing orders, dual determinations, successor billings and audits.
3. Providing Statements of Account.
4. Continuance of any petition or appeal.
5. Withholds on transfer of liquor licenses.
6. Filing of criminal complaints.
7. Correspondence or discussions with the debtor and counsel regarding the things specifically listed in this section.

When in doubt as to whether an action may violate the automatic stay, please contact the Bankruptcy Team before proceeding. A violation of the automatic stay can lead to sanctions against the BOE.

PROCEDURE WHEN NO AUDIT IS TO BE MADE — LEGAL CASES _____ **754.050**

~~The legal claim case screen should be completed for all legal claim types including Chapter 7 No Asset cases. Completion of the Audit Approval section of the legal claim case screen for a Chapter 7 No Asset case is optional. If a Chapter 7 No Asset case is later redesignated by the court to an Asset Case, then the Audit Approval Section of the legal claim case screen must be completed.~~

EFFECTS OF LAW CHANGES

740.050

Since the enactment of the Bankruptcy Code in 1978, there have been many significant amendments. Some of the more significant amendments that affect the BOE are:

1. The Bankruptcy Reform Act of 1994. The automatic stay exception was broadened to permit taxing agencies to take the following actions:
 - a. Audit to determine a tax liability.
 - b. Issue a notice of tax deficiency to the debtor.
 - c. Demand delinquent tax returns.
 - d. Make an assessment for any tax.

2. The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) became effective beginning October 17, 2005 and it:
 - a. Codified the tolling of certain periods while a previous bankruptcy case was pending.
 - b. Added exceptions to discharge in both chapter 13 and chapter 11 cases for:
 - 1) Failure to file
 - 2) Fraud

CLAIM PREPARATION ON PRE-PETITION LIABILITY

740.060

Prior to the filing of a bankruptcy proof of claim:

1. All potential pre-petition liabilities must be identified. To accomplish this:
 - a. Delinquent returns must be filed or compliance assessments should be processed and billed.
 - b. Pending audits should be completed and billed.
 - c. In cases where successor liability exists, a notice of successor liability should be issued and billed.
 - d. In cases where responsible person liability exists, a notice of dual determination should be issued and billed.

2. In addition, prior to filing a bankruptcy proof of claim, SPS staff should:
 - a. Review filed returns to determine whether they are correct.
 - b. Return any money collected in violation of the automatic stay.
 - c. Determine whether a cash deposit may be applied to the account.
 - d. Verify correct application of payments.

CLAIM PREPARATION ON PRE-PETITION LIABILITY (CONT.) 740.060

After completing the above steps, BOE staff should prepare a proof of claim including all pre-petition tax and fee liabilities. The proof of claim must indicate the appropriate designation of a liability as secured, priority, or general unsecured. If an audit or other determination has not been completed, a contingent proof of claim indicating a potential tax or fee liability should be filed.

SPS is responsible for accounts in bankruptcy legal status until the legal case is closed in IRIS. All account maintenance and compliance tasks required to prepare and file a proof of claim in a bankruptcy case will be handled by SPS. Staff in district offices and divisions within PSTD should continue to provide taxpayers with all other account related services requested by the taxpayer (e.g. provide split returns, close-out of permits, update addresses, etc.)

PRE/POST PETITION (SPLIT) RETURNS NOT YET FILED — LEGAL CASES 754.055
DELINQUENT AND SPLIT RETURNS 740.070

After transmitting a legal case from the legal claim case screen, the district office or SPS must ensure all pre-petition returns have been filed. In many cases, a Financial Obligation (FO) and tax return needs must to be split to account for liabilities incurred before and after the bankruptcy petition date.

Although this function is primarily the responsibility of SPS, if the taxpayer is present in a district office or in communication with a district office or division within PSTD, staff should assist SPS by determining whether the permit or license is active or closed out and obtaining delinquent or split returns.

A FO is established at the time the tax return is addressed for mailing.

1. • If at the time the legal claim is entered on the legal claim case screen, and the system has not yet established a FO, the system will automatically split the FO. Split tax returns will be mailed to the taxpayer by the IRIS system. Time constraints may require creating a periodic FO prior to return addressing (e.g. yearly account, that files in the middle of the year) however, if circumstances require that the returns be mailed immediately, SPS may manually prepare and mail split returns to the taxpayer.
2. • If a tax return for the full reporting period was filed without full payment, Special Procedures SPS will prorate the difference for the purpose of filing the claim.
3. • If the a FO for the entire period has been established, but the return has not been filed, the district or SPS staff will need to manually split the FO. This will to create a pre-petition and a post-petition return. District sStaff will then print and mail these returns to the taxpayer. It is the district office staff's responsibility to obtain the returns and establish follow-ups.

When pre-petition returns cannot be obtained with adequate time (two weeks) for Special Procedures SPS to file a claim, preparation of a Compliance Assessment should be prepared (see CPPM 540.200) should be considered.

AUDIT ON PRE-PETITION LIABILITY**740.080**

In all cases where an audit is to be conducted or is in process, but is not yet completed, the Audit Approval section of the legal claim case screen must be completed. Once completed, the legal claim screen will be transmitted to SPS promptly so proper controls can be established for the timely filing of a proof of claim.

Audit staff should be informed of a bankruptcy claims bar date so that an audit can be billed with sufficient lead-time to permit SPS staff to timely file a proof of claim. SPS staff needs at least 2 weeks prior to a claims bar date to process and file a proof of claim.

Audit staff should periodically communicate with SPS staff regarding the status of the audit. If there are problems or delays in the completion of the audit, communication should take place as early as possible to insure that all required steps to preserve the BOE's claim are taken by both audit staff and SPS.

If audit staff is contemplating an audit after a bankruptcy case was filed and the audit period is pre-petition, or pre-confirmation (Chapter 11 cases), audit staff should contact the Bankruptcy Team to determine whether the bankruptcy case affects the liability not yet billed, prior to investing time in an audit.

For requests for Determination of a Tax Liability pursuant to section 505(b)(2) of the bankruptcy code, see CPPM 740.190.

DUAL DETERMINATIONS ON PRE-PETITION CORPORATE LIABILITY**740.090**

Revenue and Taxation Code §6829

Sales and Use Tax Regulations 1702.5 and 1702.6

If an officer of a corporation that has a liability with the BOE files a bankruptcy petition, the corporate account should be reviewed for a possible responsible officer dual determination against the officer. If a responsible person dual determination cannot be completed in time to file a proof of claim, but there are indications that a responsible person liability may be established, SPS staff should file a contingent claim. A contingent claim asserts the potential liability of the corporate officer.

DISPOSITION OF SECURITY—LEGAL CASES

754.060740.100

Revenue and Taxation Code §6815 and §6701

~~When disposing of security at the time of close-out in bankruptcy, assignment, receivership and probate cases, the security must be returned in care of the representative who is entitled to receive it, even though the checks are made payable to the entity that posted the security.~~

~~In bankruptcy cases, when the account is closed out with no delinquencies or liabilities pending or otherwise, the security should be returned in care of the bankruptcy trustee. This procedure will also be followed when the security was posted by a partnership and not all the members of the partnership are bankrupt.~~

~~When the taxpayer continues to operate as a debtor in possession in Chapter 11 cases, the amount posted will be retained as security for the account, and a claim will be filed for the full amount of the liability. When the account is closed, and there is no liability, no audit, and all returns have been filed and paid, the security should be returned to the trustee or debtor in possession.~~

~~In assignment cases, return of security, if warranted, will be made in care of the assignee. In receivership cases, it will be made in care of the receiver.~~

~~In probate cases, the security will be returned in care of the attorney representing the estate of the deceased taxpayer. If the security was posted by a partnership and one of the partners is deceased, the security will be returned in care of the surviving partner or partners.~~

If a bankruptcy case is pending when an account is closed out with no delinquencies or liabilities pending or otherwise, the taxpayer's security deposit should be returned in care of the:

1. Bankruptcy trustee (Chapter 7 cases).
2. Debtor-in-Possession (DIP) or trustee (Chapter 11 cases).
3. Debtor (Chapter 13 cases).

If a liability exists when an account in bankruptcy status is closed out, the taxpayer's security deposit should be applied to the outstanding liability and the Bankruptcy Team notified so that a review of the account can be made. Any security in the form of cash, government bonds, or insured deposits in banks or savings and loan institutions shall be held by the BOE in trust to be used solely in the manner provided by Revenue and Taxation Code (RTC) sections 6701 and 6815. Generally, demands are not made on surety bonds or guarantees until after the bankruptcy case is closed.

PRE-PETITION CLAIMS (IN GENERAL)

740.110

USBC §502

USBC §507

"Sales tax", "excise tax", and "fees", as used in this section, are from section 507(a)(8) and other pertinent sections of the United States Bankruptcy Code. Definitions of "sales tax", "excise tax", and "fees" may differ under California laws.

Types of Pre-petition Claims

1. **Priority Claim:** A priority claim can be filed for a liability that qualifies for priority under §507(a)(8) of the bankruptcy code. This includes:

- a. Sales tax liabilities for which returns were due within three years of the petition date.
- b. Sales tax liabilities that became final within 240 days of the petition date.
- c. Sales tax liabilities that were assessable, but not yet assessed, as of the petition date.
- d. Excise tax liabilities (includes use tax) for which a return is required and due within three years of the petition date.
- e. Excise tax liabilities (includes use tax) that arise from a transaction occurring within three years of the petition date.

(These periods may be tolled for cases in which a prior bankruptcy case or offer-in-compromise was pending.)

1. **Secured Claim:** A secured claim is a tax or fee liability secured by an interest in real or personal property when:
 - a. The BOE has a valid pre-petition lien filed with the Secretary of State's Office or the BOE has a valid pre-petition lien recorded with a county recorder's office in which the debtor owns real property as of the petition date, and
 - b. There appears to be equity in the property to which the BOE's lien attaches.

2. **General Unsecured Claim:** A general unsecured claim is a tax or fee liability that is neither entitled to priority treatment nor secured.

3. **Gap Claim:** When a debtor is forced into bankruptcy through the filing of an involuntary petition, the period after the commencement of the involuntary case, but before the order of relief, is referred to as the "gap" period. A tax liability arising during the gap period is entitled to priority and should be asserted as a gap claim.

Emergency Proof of Claims

Occasionally, a district office may be asked by the Bankruptcy Team to file a proof of claim with a bankruptcy court to meet a claim bar date.

In these cases, SPS will e-mail a copy of the claim to the district office. The proof of claim should be signed by a Business Taxes Compliance Supervisor II at the district office. The district will then be responsible for filing the proof of claim with the bankruptcy court. If there is no district office located near the court, SPS will e-mail the proof of claim to the district office nearest the bankruptcy court. Once a proof of claim has been filed with a bankruptcy court, the district office should provide SPS with a court-stamped copy of the proof of claim.

Claims Bar Date

With few exceptions, proof of claims must be filed before a claims bar date to be paid. The law allows governmental units 180 days from the bankruptcy petition date to file pre-petition claims. However, if a different bar date has been set by court order, then BOE must follow that bar date.

Proofs of claim in chapter 13 cases should be filed prior to the date first set for hearing on confirmation of a debtor's chapter 13 plan.

Claims Agent

Proofs of claim must be filed at the address designated for filing. In large chapter 11 cases, a claims agent may be assigned to administer claims. In those cases, the BOE may be directed to file its proof of claim with the agent – not the bankruptcy court.

CHAPTER 7 BANKRUPTCY**740.120**

USBC Chapter 7 in General, Specifically §727
USBC §523

A chapter 7 bankruptcy case is a liquidating bankruptcy case. A chapter 7 case can be commenced by an individual or a business entity through the filing of a bankruptcy petition, or by creditors who file an involuntary petition.

A chapter 7 trustee is appointed to administer a chapter 7 case. The trustee is responsible for gathering the debtor's non-exempt assets, if any, reducing those assets to cash (when appropriate), and making distributions to creditors in accordance with the distribution provisions of the Bankruptcy Code. All legal or equitable interests of a debtor in property as of the petition date become property of a debtor's bankruptcy estate.

Chapter 7 cases can be considered either "asset" or "no asset" cases. Although a debtor's voluntary petition will state whether a case is believed to be an asset case or a no asset case, the chapter 7 trustee ultimately makes this determination. If a trustee declares the case to be a no asset case, but later recovers assets for distribution to creditors, the designation can be changed, with a notice sent to creditors to file a claim.

Late Proofs of Claim

The law allows the BOE to file a late proof of claim in a chapter 7 case as long as the proof of claim is filed on or before (1) the trustee's commencement of a final distribution to creditors, or (2) 10 days after the mailing to creditors of a summary of the trustee's final report, whichever comes first. Nevertheless, every attempt should be made to file a proof of claim before a claims bar date.

The BOE's proof of claim should include all unpaid taxes and fees and all interest accrued to the petition date. In a separate category, the proof of claim should include post-petition interest and penalties. In surplus cases where unsecured creditors will be paid in full, the BOE may be entitled to receive a distribution on its post-petition interest and penalties.

Discharge

A discharge in bankruptcy is typically issued by a bankruptcy court within 180 days of the petition date. Only individuals are entitled to receive discharges in chapter 7 cases.

Closure

The date of closure of a chapter 7 bankruptcy case depends on whether the case is an asset or a no asset case. No asset cases typically close within a few months of the petition date. Asset cases typically close many months, if not years, after the petition date.

Resumption of Collection Activity

If a tax or fee liability to the BOE is excepted from discharge, BOE staff may resume collection activity against a debtor and a debtor's assets that are not included within a bankruptcy estate, after the debtor receives a discharge in bankruptcy. Ordinarily, BOE staff waits until a bankruptcy case is closed to commence collection action to avoid any possibility of violating the automatic stay.

A case will remain under SPS control as long as SPS deems necessary. Staff should not pursue collection against a debtor without SPS direction while a case remains under SPS control due to a bankruptcy.

PRE-PETITION CLAIMS (IN GENERAL)**(CONT. 2) 740.120**

Pursuant to Bankruptcy Code section 523, certain liabilities are excepted from a chapter 7 discharge. The following types of liabilities are excepted from discharge:

1. Priority tax debt (see CPPM 740.110 and USBC §507).
2. Tax liabilities associated with a fraudulent return.
3. Tax liabilities for which the debtor made an attempt to evade or defeat the tax.
4. Tax liabilities associated with the debtor's failure to file returns.
5. Tax liabilities associated with returns filed late and within 2 years of the petition date.

If a tax or fee liability is discharged and it is not secured by a valid state tax lien, then SPS will process an adjustment to the liability within IRIS. If a liability is discharged, but a valid state tax lien secures the liability and was recorded before the petition date, a "Discharge from Accountability" should be processed online (see CPPM 740.160). If the lien is released at a subsequent date, SPS staff will adjust the liability.

CHAPTER 13 BANKRUPTCY CASES**740.130**

USBC Chapter 13 in General, Specifically USBC §1305, §1325, and §1328

Chapter 13 bankruptcy cases enable individuals only (not legal entities) with regular income to repay all or part of their debts pursuant to the provisions of a plan confirmed by order of a bankruptcy court. Debtors make installment payments to a chapter 13 trustee, who, in turn, makes a distribution to creditors. The term of the plan is usually three to five years.

Basic Terms of a Chapter 13 Plan (USBC §1325)

The debtor's plan should:

1. Provide for installment payments.
2. Not exceed 5 years in duration.
3. Pay priority claims in full.

A chapter 13 trustee and creditors can object to confirmation of a debtor's proposed plan if it is not feasible or if the plan does not provide for the proper amount, treatment, or payment of the claims of the creditors.

The Bankruptcy Team will monitor chapter 13 cases to insure that all payments that the BOE is entitled to receive under a confirmed chapter 13 plan are being timely paid to the BOE and applied correctly to pre-petition liability.

Claim

In a chapter 13 case, the BOE's proof of claim may include only pre-petition tax and pre-petition interest. BOE proofs of claim filed after a claims bar date usually receive no distributions from the chapter 13 trustee, and the liability may be ultimately uncollectible if the debtor receives a discharge in bankruptcy.

Post-Petition Tax Liabilities

A chapter 13 debtor is required to timely report and pay post-petition tax liabilities while a bankruptcy case is pending. Since the automatic stay remains in effect until a debtor receives a discharge or the case is dismissed, the BOE may not take collection action on post-petition liabilities. The BOE may move to dismiss a case or convert a case to a chapter 7 if a taxpayer does not report or pay a post-petition tax liability. The BOE may also file a claim under Bankruptcy Code section 1305 (see CPPM 740.170). The BOE's Legal Department must be consulted before filing a section 1305 claim. Efforts should be made to collect a post-petition tax liability by voluntary compliance before either course of action is pursued.

Discharge (USBC §1328)

A chapter 13 debtor does not receive a discharge until all payments under a plan have been made and a plan is otherwise consummated. A chapter 13 discharge, for cases filed prior to October 17, 2005, discharges all tax liabilities arising prior to the petition date. If a bankruptcy case is filed after October 17, 2005, tax liabilities resulting from the debtor's failure to file returns or fraud are excepted from discharge.

The Bankruptcy Team will process any necessary legal adjustments and lien releases for tax and fee liabilities that are discharged in a chapter 13 bankruptcy case.

In some chapter 13 cases, a debtor can receive a hardship discharge without completing all plan payments. The Bankruptcy Team should be consulted to determine the effect of a hardship discharge on a BOE liability.

A chapter 11 bankruptcy case can be either a reorganization case or a liquidation case. Occasionally a trustee will be appointed to administer a chapter 11 case, but generally a debtor remains in control of the assets and business affairs as a DIP (DIP).

Plan (USBC §1129)

In most chapter 11 cases, a DIP or trustee is required to file a disclosure statement and a plan of reorganization or liquidation. A disclosure statement should explain in ordinary terms the reasons why the debtor commenced its bankruptcy case, describe in ordinary terms how creditors' claims will be treated, and describe how the debtor will reorganize or liquidate.

The BOE often has a priority tax claim in a chapter 11 case. The Bankruptcy Code requires a priority tax creditor to be treated not less favorably than as follows:

For cases filed prior to October 17, 2005:

1. Deferred cash payments.
2. Payment of a priority tax claim under a plan are not to exceed 6 years from the date of assessment.
3. Priority tax claims should include all pre-petition taxes or fees and all interest accrued to the petition date.
4. Allowed claims are required to be paid in full, plus post-confirmation interest on the claim at a rate set by the court.

For cases filed after October 17, 2005:

1. Regular installment payments.
2. Payment of a priority tax claim under a plan cannot extend beyond 5 years from the petition date.
3. Treatment of a priority tax claim will include all pre-petition taxes or fees and all interest accrued to the petition date and will not be less favorable than the most favored non-priority unsecured claims.
4. The BOE's allowed priority tax claim must be paid post-confirmation interest at the BOE's rate as of the date of confirmation.

If a proposed plan does not properly provide for treatment of the BOE's claim, the BOE may object to confirmation of the plan.

Claim

In a chapter 11 bankruptcy case, a BOE claim includes only pre-petition tax and/or interest.

Plan Default

Once a chapter 11 plan is confirmed, the BOE cannot collect on a pre-confirmation tax or fee liability except as provided for in the confirmed plan. If there is a default in payment under a confirmed plan, the BOE can declare a default under the confirmed plan, notify the plan administrator of the default, and demand payment. If the demand is not met, the BOE can collect the full unpaid balance of the amount of its allowed proof of claim.

1. “**Notice of Default**” letter is sent approximately 30 days or more after the debtor defaulted on the plan.
2. “**Notice of Breach of Contract and Demand for Payment**” is sent approximately 60 days after a debtor defaults on a confirmed plan and after no response to the first letter. It sets a response deadline by which the BOE will consider the default a breach of contract and will begin collection action.

Once the date specified in the second letter passes, the Bankruptcy Team may remove the account from legal status and return the account to the staff responsible for collection action in the district office or division of PSTD. Collections are limited to the liability provided by the confirmed plan. This will include the monitoring of legal interest on the claim. The Bankruptcy Team should be consulted if there are any questions as to what should be collected – or about how to monitor the payments. (See CPPM 740.150 for specifics on the Discharge Review process).

Post-Petition Collections

The DIP or trustee who continues with the operation of the business is required to comply with the requirements of the law to file tax returns and pay taxes as they come due. Any liability that accrues subsequent to the date of the petition and prior to confirmation of a plan is an expense of administration, and, as such, is entitled to expense of administration priority. An expense of administration claim should be filed prior to plan confirmation. See CPPM 740.170 for more information on expense of administration claims. Any liability that accrues after confirmation of a plan can be collected as if the debtor was not in bankruptcy.

CHAPTER 11 BANKRUPTCY CASES

(CONT. 2) 740.140

Discharge of a Tax or Fee Liability upon Confirmation (USBC §1141)

In chapter 11 cases filed prior to October 17, 2005, for both individuals and legal entities, discharge occurred upon confirmation of a plan. A full discharge is only granted to corporate debtor's, not to individuals. A discharge for an individual is subject to the same exceptions to discharge provided by Bankruptcy Code section 523 in a chapter 7 case.

In chapter 11 cases filed on or after October 17, 2005, BOE tax and fee liabilities owed by legal entities are discharged when a plan of reorganization is confirmed. Tax and fee liabilities owed by individuals are discharged only when a plan of reorganization is fully paid and otherwise consummated. Plans of liquidation should not contain a discharge provision because discharge is not allowed in these cases.

In legal entity cases filed prior to October 17, 2005, a discharge under chapter 11 discharges all liabilities incurred prior to the confirmation date. For cases filed after October 17, 2005, tax liabilities incurred either for failure to file a return or associated with a fraudulent return are excepted from discharge.

While an account remains in chapter 11 bankruptcy status, the Bankruptcy Team will monitor the case to insure that all plan payments are made to the BOE. After all payments have been made, the Bankruptcy Team will make any necessary adjustments to the liability and route the account back to the district office if a collectible liability still exists.

DISCHARGE REVIEW

740.150

After a taxpayer receives a discharge in bankruptcy or a proof of claim for a tax or fee liability is paid through a bankruptcy case, or both, it will be the responsibility of SPS to:

1. Determine the extent to which a BOE liability has been satisfied through payment.
2. Determine whether or not a BOE tax or fee liability has been discharged in bankruptcy.
3. Legally adjust discharged liabilities using the IRIS legal adjustment process.
4. Apply discharge-in-bankruptcy (DFB) status to any liability periods in the IRIS Difference System (DIF) that are discharged.
5. Post notes in ACMS, using the Legal Case Summary (BX) header from the Case Summary Notes window, that specifically describe the discharged and non-discharged status of pre-bankruptcy balances.
6. Analyze whether a pre-bankruptcy BOE tax lien has survived the discharge (CPPM 740.160).
7. Release BOE tax liens that have not survived a bankruptcy discharge.
8. Post notes to ACMS, using the Legal Case Summary (BX) header from the Case Summary Notes window, specifically describing property/conditions to which any surviving lien remains attached.

DISCHARGE REVIEW**(CONT.) 740.150**

9. Post notes in ACMS, using the Legal Case Summary (BX) header from the Case Summary Notes window, regarding any joint debtor accounts (partnership, husband and wife co-ownership, etc.) as to dischargeability for the specific joint debtor who has received a discharge.
10. Issue a demand for any non-discharged liability.

LIENS ON DISCHARGED DEBT**740.160***In re Carlson 292 F.Supp. 778**In re Isom 901F.2d 744*

Generally, in a chapter 7 case, tax liens on a liability that has been discharged survive bankruptcy if the liens attached to real or personal property prior to a bankruptcy filing. The BOE retains the legal right to collect the tax liability, but only from the property to which the tax lien attached prior to the bankruptcy case and not from the tax debtor personally. Where a tax liability is discharged, but the tax lien survives a bankruptcy discharge, the tax liability should not be legally adjusted. Instead, collection staff will submit an online "Discharge from Accountability" to SPS. If, at a future time, the lien is released (see below), SPS will process a legal adjustment at that time.

If a taxpayer wishes to obtain a lien release on a liability that was discharged through bankruptcy, it must establish to SPS' satisfaction that the lien did not attach to any pre-petition property. Evidence to support this assertion includes:

1. A Title Report certifying that a search of the grantor/grantee index of the county where the lien was recorded discloses no property in the debtor's name or transferred to or from the debtor's name from the time the lien was recorded until the petition date.
2. Copy of bankruptcy schedule "A" showing no real property.
3. Copy of IRS tax returns for the years between the day the lien was recorded to the day the bankruptcy petition was filed.
4. Statement under penalty of perjury that the taxpayer owned no property, nor had property transferred to or from his ownership between the date the lien was recorded and the petition date.
5. If property was owned, but was subject to foreclosure, all documents/deeds verifying this transfer must be provided.

SPS will review the documentation provided and if it is satisfied the lien has no value (does not attach to any property), it will release the lien. These requests are subject to approval by the supervisor of SPS.

Enforced collection against a tax debtor or a tax debtor's property must not take place on any discharged debt, except as against property to which the BOE's tax lien attached and as permitted under BOE policy.

POST-PETITION CLAIMS

740.170

USBC §503 and §1305

Post-petition claims include:

1. Expense of Administration Claims (EOA):
 - a. In a chapter 11 case in which the debtor incurs tax liability after filing bankruptcy but before confirmation of a chapter 11 plan, an EOA claim should be filed for the liability between the petition date and the confirmation date, if the tax liability is not voluntarily reported and paid.
 - b. In a chapter 11 or 13 case in which the debtor incurs tax liability after filing bankruptcy, but the case converts to a chapter 7 case, an EOA claim should be filed for any liability incurred between the petition date and the conversion date.

2. Section 1305 Claims: Pursuant to Bankruptcy Code section 1305, the BOE may file a claim for unpaid taxes incurred while a chapter 13 case is pending, however, such claims should be filed only after consulting with the BOE's Legal Department.

Both EOA and section 1305 claims include tax, interest and penalties (full debt as of the date the EOA or section 1305 claim is filed).

SALE OF ASSETS OF A DEBTOR DURING BANKRUPTCY

740.180

Business and Professions Code §24074 and §24049

In re Farmers Market Inc. 792 F.2d 1400

California State Board of Equalization v. Goggin 191 F.2d 726

California State Board of Equalization v. Sierra Summit 490 U.S. 844

1. Liquor Licenses:

The BOE should place withholds on transfers of liquor licenses when it is discovered that a debtor has filed for bankruptcy.

California Business and Professions Code Sections 24049 and 24074 provide that all liabilities owed to the BOE, the Franchise Tax Board, the Employment Development Department, the Alcoholic Beverage Control, and unsecured county taxes incurred in connection with a liquor license shall be paid prior to distribution of any funds to any other person.

SALE OF ASSETS OF A DEBTOR DURING BANKRUPTCY

(CONT. 1) 740.180

The BOE is entitled to payment of the sales proceeds of a liquor license to the extent necessary to satisfy an unpaid tax or fee liability. If there are insufficient sales proceeds to pay a BOE tax liability in full, then the BOE takes the full sales proceeds and applies them to the liability. The BOE should be paid outside a bankruptcy case and directly from escrow.

2. Sale of Personal Property (Liquidation Sales):

An Asset Purchase Agreement (APA) is a contract between a buyer and a seller (the seller may be a debtor in possession or a trustee) for the purchase of substantially all the assets of the debtor's bankruptcy estate. The APA many times will describe the assets, the purchase price, conditions to closing, real estate matters, assumptions of liabilities, and other details that are required to complete the transfer of the assets from one party to the other. An APA must be approved by the court. The BOE, along with other creditors, may object to the sale.

APAs are often found in large liquidating cases. The APA should be reviewed closely to determine if there is any California taxable tangible personal property being sold – usually in the form of fixtures and equipment.

SPS staff may request audit staff to review the APA to determine the tax consequences of a sale. Taxpayers should be encouraged by BOE staff to declare the amount due on a Sales and Use Tax Return – or to state in writing the amount of the measure of the tax liability. If the APA does not specify a value for the fixtures and equipment, BOE staff should prepare an estimate of value.

Once the amount of the tax liability is declared by a taxpayer, or determined by the BOE, an EOA claim should be filed for the full amount due if the liability is not voluntarily paid.

If an objection to an EOA claim is filed, the BOE must defend it in bankruptcy court or the claim may be disallowed and the BOE will not receive a distribution.

When a trustee or a DIP employs an auctioneer/liquidator to sell the assets of the estate, any taxes are to be reported and paid by the auctioneer/liquidator.

SALE OF ASSETS OF A DEBTOR DURING BANKRUPTCY (CONT. 2) 740.180

The effective date of payment on all remittances received from the bankruptcy court/trustee on taxable liquidation sales will be the date the court approves the payment. All additional interest that has accrued from the time payment is approved by the court to the time the BOE actually receives the money will then be backed out.

3. Sale of Real Property:

If a trustee or DIP is selling real property located in a county in which the BOE has a lien, the BOE can require that the lien be paid in full prior to a release of the lien.

The trustee can request that a sale take place "free and clear" of all liens and encumbrances. Although this removes the lien from the property, the lien will usually attach to the proceeds of the sale to the same extent and validity. The funds should then be disbursed according to the priority of the liens filed. If there are other governmental agencies (FTB, IRS, EDD) involved, the agencies will typically use assessment dates instead of recording dates to determine who should receive payment (although bankruptcy is excluded from the requirements of the Inter-Agency Agreement, its guidelines are still utilized in lien comparisons between agencies during bankruptcy). The BOE Legal Department should be advised and consulted upon receipt of a motion to approve a sale free and clear of a BOE lien or interest.

If there is not enough money (equity) in the property to pay the BOE's lien, then the BOE does not receive payment – the lien remains in place (i.e. recorded in the county), but the property was sold free and clear.

4. Retail Sales:

If a trustee is continuing the business or if there will be a taxable liquidation sale by a trustee who does not hold a valid seller's permit for the estate, an account will need to be issued. The account should be opened in the name of the estate or the trustee, just as if the trustee was a regular taxpayer. (See CPPM 210.010, *Sellers Permit*).

If the trustee is declaring the proceeds from one sale or a few sales, then an arbitrary account number should be issued with the reason "bankruptcy, liquidation" cross-referencing the debtor's account number. Arbitrary accounts are used because they will not create delinquencies leading to the revocation of the trustee's account. At the time of registration, the district office will provide the trustee with a tax return and information pertaining to the taxability of the liquidation sale and the completion of the return.

SALE OF ASSETS OF A DEBTOR DURING BANKRUPTCY**(CONT. 3) 740.180****5. Other BOE Accounts**

In the event a trustee requires a seller's permit to continue an ongoing business, or an arbitrary account to report liquidation of assets, district office staff should determine whether the trustee needs to be registered for any other BOE programs. District office staff should review the predecessor's Taxpayer Identification Number for additional BOE accounts. In the event the trustee needs additional BOE accounts, district office staff should contact PSTD and advise them of the potential new accounts.

In such cases, a District Principal Compliance Supervisor (or their designee) should send an email notification to the Operations Manager of the Property and Special Taxes Department. The email should be sent to the Outlook mail box titled "PSTD-Referrals from SUTD."

The email notification should include the name, address and phone number of the trustee. The notification should also include the predecessor's and trustee's seller's permit number. The notification should include other BOE accounts the predecessor held prior to the trustee assuming control of the business. PSTD staff will review the notification and forward the information to the appropriate division for further action, as well as appropriate account maintenance on the predecessor's PSTD-related accounts.

REQUESTS FOR PROMPT DETERMINATION OF TAX**740.190**USBC §505(b)(2)

Under Bankruptcy Code section 505(b)(2), a trustee or taxpayer may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the estate by submitting a tax return and a request for such a determination. The trustee and the debtor will be discharged of any liability for any unreported tax if:

1. The BOE does not notify the trustee within 60 days that the return has been selected for examination (audit).
2. After notifying the trustee the account will be examined, the BOE does not notify the trustee within 180 days of the additional amount due (if any) or within such additional time as the court permits.
3. Once the amount determined by the BOE, or the court, is paid.

When staff is contacted by SPS concerning requests made under Bankruptcy Code section 505(b)(2), it is important that they process such requests to examine or audit returns on a priority basis.

BANKRUPTCY PROCEEDINGS – VALID SERVICE UPON THE BOARD**754.190****VALID SERVICE UPON THE BOARD****740.200**

The Rules of Bankruptcy Procedure and the Federal Civil Rules of Procedure are very specific in reference to what constitutes valid service. The Board is presumed to have received proper notice when it is served in compliance with the following rules:

1. Summons and Complaint for Adversary Proceedings:

Pursuant to Federal Rule of Bankruptcy Procedure 7004(b)(6) and California Code of Civil Procedure (CCP) section 416.50, the summons and complaint must be served upon the BOE's Executive Director at:

Board of Equalization

Executive Director

450 N Street, MIC: 73

Sacramento CA 95814-0073

2. Service on the California State Board of Equalization

Pursuant to Federal Rule of Bankruptcy Procedure 2002, the following address has been designated for all bankruptcy notices, unless otherwise indicated:

California State Board of Equalization

Account Information Group, MIC 29

P.O. Box 942879

Sacramento CA 94279-0029

3. Objections to Claims

Pursuant to Federal Rule of Bankruptcy Procedure 3007, a Notice of Objection to Claim must be served at the address specified on the Proof of Claim filed by the BOE.

Requests for Prompt Determination of a Tax Liability

Pursuant to Bankruptcy Code section 505(b)(1)(A) the address designated for service of all section 505(b) requests for prompt determination of tax liability is:

California State Board of Equalization

Special Procedures Bankruptcy Team, MIC 74

P.O. Box 942879

Sacramento CA 94279-0074

PARTNERS IN BANKRUPTCY

740.210

When two or more persons are jointly responsible for payment of a BOE tax liability (partnership accounts, husband and wife co-ownership accounts, etc.), SPS will be responsible for determining which liabilities, if any, have been discharged by a joint debtor's bankruptcy discharge. If all joint debtors have discharged liabilities, the liabilities may be legally adjusted. If not, the tax liability should not be adjusted, nor should the Discharge From Bankruptcy (DFB) status code be set. If a lien release is appropriate for a discharged joint debtor, but not for all joint debtors, a partial release as to the affected person should be issued.

A partner that is not in bankruptcy is not protected by the automatic stay of a partner in bankruptcy. Collection can continue on the partner not protected by the automatic stay.

APPLICATION OF BANKRUPTCY PAYMENTS

740.220

Payments made during a pending bankruptcy need to be closely monitored. Only SPS should change applications of bankruptcy payments (i.e. payments from a trustee or DIP).

4. Payments made by an estate, trustee, or debtor for payment of a bankruptcy claim through the bankruptcy court must be applied to the periods specified in the BOE's proof of claim.
5. Payments made by an estate, trustee, or debtor for payment of a secured liability must be applied to the liability which that asset secured (i.e. if not all periods are subject to a lien, then proceeds from the sale of a property should be applied to the liabilities that are subject to a lien).
6. Payments made by a debtor after the petition date must be applied to the debtor's post-petition liability. (The only exception is if a chapter 7 debtor wants to make voluntary payments toward pre-petition debt, as he will still owe it when his bankruptcy has concluded).
7. Over-payments made prior to the bankruptcy must be either applied to pre-petition liability or refunded to the trustee or DIP.

When collection staff have questions concerning the application of a payment, they should contact the Bankruptcy Team.

If a payment from a source outside the bankruptcy proceedings alters the BOE's filed claim, the Bankruptcy Team should be notified to review the claim for possible amendment.

BANKRUPTCY IN IRIS

740.230

Important Legal Screens:

1. **LGL LC (Legal Case):** To see the information entered, or to enter information on IRIS concerning a legal case.
2. **LGL SC (See Claim):** To see what claim or claim(s) the BOE may have filed on any given case.
3. **LGL MC (Make Claim):** Used only by SPS staff to enter information about a new claim.
4. **LGL AG (Attorney General):** To see the information entered, or to enter information on IRIS concerning an Attorney General case (only SPS staff can enter an AG case).

Staff may access legal subsystem screens by using 1) the account number-(a), 2) the case number-(c) or 3) the case id number-(i).

Accessing Legal Screens by Account Number, Case Number or Case Id Number:

1. BOE Account Number: Users should enter the desired LGL screen on the first two spaces of the "GO" line in IRIS. On the third space, users should enter the letter "A", followed by the nine-digit BOE account number.
2. Bankruptcy Case Number: Users should enter the desired LGL screen on the first two spaces of the "GO" line in IRIS. On the third space, users should enter the letter "C", followed by the bankruptcy case number.
3. Case ID Number: Users should enter the desired LGL screen on the first two spaces of the "GO" line in IRIS. On the third space, users should enter the letter "I", followed by the case ID number.

Initial Legal Entry:

1. Promptly upon learning the taxpayer is involved in bankruptcy, staff will obtain the required information and complete the Legal Claim Case screen online (LGL LC).
2. Lists of appropriate TIN numbers to use for courts, chapter 13 trustees, and some chapter 7 trustees have been provided to all districts. If collectors need assistance relating to TIN numbers for courts and trustees in the LGL-LC screen, they should contact SPS.
3. The case must be transmitted using the F20 key in order for the account to be put in legal status.

During the Pending Bankruptcy:

1. Pre-petition periods are marked with B07, B11, or B13 (on DIF DA) depending on the type of bankruptcy filed.
2. Liability in a chapter 11 that is post-petition, but pre-confirmation, is marked with just the letter "B."
3. Post-petition and post-confirmation chapter 11 periods are not marked.
4. Staff will not be able to send a demand on any period "marked" with a bankruptcy indicator.

After the Bankruptcy Concludes:

1. SPS will mark any discharged period with a DFB indicator in the "status" column. Occasionally the DFB indicator will be hidden under other status indicators. Staff should use the DIF DI screen and place an "M" on the moreable field to view the status for the period.
2. Once a discharged period is marked "DFB", a demand for payment cannot be issued for that period. However, a statement of account may be issued to the taxpayer.
3. Collection should not take place on any period marked with a DFB status indicator.
4. Questions concerning why a DFB status indicator is placed on a particular liability should be directed to SPS.

BANKRUPTCY IN ACMS**740.240**

1. Initial entry and transmission of the legal screen will automatically route the account to SPS for monitoring, on the next day. Do not place a hold on the account because it could impede this automatic process.
2. Once the bankruptcy case is removed from legal status, the case will automatically route to the district office or PSTD division of control the following day.
3. Collections staff should look for the comment under "Legal Case Summary" in ACMS that gives them a review of the impact of the bankruptcy proceedings on the liability prior to working the account.
4. DFB status on any given liability will be reflected in ACMS. ACMS will stop and/or warn regarding any collection on a liability marked with a DFB indicator.
5. Any questions regarding comments made in ACMS in reference to a bankruptcy should be directed to the Bankruptcy Team member that made the comment.

GLOSSARY OF BANKRUPTCY TERMS**740.250**

TERM	DEFINITION
<u>Assets Abandoned by Trustee</u>	<u>The trustee in bankruptcy may decide not to retain certain assets of the debtor as part of the bankruptcy estate. For example, the debtor may not have sufficient equity in certain assets to make retention of those assets worthwhile for the estate. The trustee may petition the court for abandonment of the assets and, if approved, the assets are released from the estate. The debtor may also file a motion to compel the trustee to abandon particular assets on the grounds that they are burdensome to the estate, or of inconsequential value or benefit to the estate.</u>
<u>Automatic Stay</u>	<u>The filing of a bankruptcy petition operates as a stay of (in effect, an injunction against) collection activities, including the commencement or continuation of judicial and administrative proceedings, the enforcement of liens, the setoff of mutual debts, and all actions to collect, assess, or recover a claim that arose before the bankruptcy filing. The stay does not prevent or stop an audit to determine tax liability, the issuance of a notice of tax deficiency, a demand for tax returns, or the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment. Creditors acting in violation of the stay may be sanctioned by the court.</u>
<u>Claims Bar Date</u>	<u>The deadline date by which claims for pre-</u>

TERM	DEFINITION
	<u>petition liabilities must be filed.</u>
<u>Administrative Claims Bar Date</u>	<u>The deadline date by which claims for post-petition liabilities must be filed.</u>
<u>Bankruptcy Code</u>	<u>The informal name for Title 11 of the United States Code, the federal bankruptcy law.</u>
<u>Bankruptcy Estate</u>	<u>The commencement of a bankruptcy case creates an estate, which is comprised of all property, real and personal, of the debtor as of the commencement of the case, plus property acquired by the estate during the case.</u>
<u>Case Closed</u>	<u>Administration of the bankruptcy estate is complete and the case is closed.</u>
<u>Chapter 7</u>	<u>The chapter of the Bankruptcy Code providing for liquidation, i.e., the sale of the debtor's nonexempt property and distribution of the proceeds to creditors.</u>
<u>Chapter 9</u>	<u>The chapter of the Bankruptcy Code providing for the reorganization of a political subdivision, municipality, public agency, or instrumentality of a state.</u>
<u>Chapter 11</u>	<u>The chapter of the Bankruptcy Code providing for the reorganization of a business or of the financial affairs of an individual or a husband and wife (can also be a liquidation)</u>
<u>Chapter 12</u>	<u>The chapter of the Bankruptcy Code providing for the adjustment of debts of a family farmer with regular income.</u>
<u>Chapter 13</u>	<u>The chapter of the Bankruptcy Code providing for the adjustment of debts of an individual with regular income.</u>
<u>Claims in Bankruptcy</u>	<u>A creditor's assertion of a right to payment from the debtor or the debtor's property.</u>

TERM	DEFINITION
<u>Confirmed Plan of Reorganization</u>	<u>Court approved plan that provides the terms of debt repayment, and that often re-vests the assets of the bankruptcy estate in the reorganized debtor.</u>
<u>Date of Order of Relief</u>	<u>The date of filing of any voluntary petition, or the date that that court enters an order for relief against the debtor in an involuntary case (commenced by creditors).</u>
<u>Debtor</u>	<u>A person or entity that has filed a petition for relief under the Bankruptcy Code.</u>
<u>Debtor in Possession (DIP)</u>	<u>A debtor who remains in control of the administration of the business and assets of the debtor's estate during a chapter 11 case. A DIP has powers and authority similar to those of a court appointed chapter 11 trustee.</u>
<u>Discharge</u>	<u>The release of a debtor from personal liability for dischargeable debts. A discharge operates as an injunction against the commencement or continuation of any action to collect, recover, or offset a discharged debt as a personal liability of the debtor.</u>
<u>Dismissal</u>	<u>Places the parties in essentially the same position as before the bankruptcy was filed.</u>
<u>Dividend</u>	<u>Monies received from the bankruptcy estate as a result of a claim.</u>
<u>Expense of Administration Claims (or Administrative Claims)</u>	<u>The actual, necessary costs and expenses of preserving the bankruptcy estate. Generally, claims arising after the commencement of the case are administrative claims. Tax debts incurred by the estate (i.e. after the case commenced) are administrative claims.</u>
<u>Gap Period Claim</u>	<u>A creditor's claim that arises in an involuntary case after the petition is filed but before the issuance of the order for relief.</u>

TERM	DEFINITION
<u>Involuntary Bankruptcy</u>	A bankruptcy petition filed by creditors against a debtor. The court will order relief against the debtor (order the debtor into a bankruptcy) if a debtor is generally not paying his/her debts as they become due. The automatic stay applies upon filing the petition. Until the court enters an order for relief, may continue to use, acquire, or dispose of property. An involuntary case can only be filed in a chapter 7 or chapter 11 bankruptcy. When dealing with an involuntary petition, complete the legal claim screen and transmit to SPS. Enter BI7 in the "type" field.
<u>No-Asset Case</u>	A chapter 7 case in which there are insufficient assets to warrant liquidation and distribution to creditors. A no-asset case may later become an asset case if assets are discovered. Conversely, a case originally believed to be an asset case may become a no-asset case.
<u>Petition</u>	The document that commences a bankruptcy case.
<u>Priority of Claims</u>	<ol style="list-style-type: none"> 1. In cases filed on or after October 17, 2005, claims for child, spousal and family support have first priority. In cases filed before October 17, 2005, these claims have seventh priority, just ahead of tax claims. 2. Expense of Administration Claims. 3. Gap Period Claims. 4. Claims for wages, salaries, and commissions owed by the debtor, with certain limitations. 5. Claims for contributions to employee benefit plans, with certain limitations. 6. Certain claims of grain producers and U.S. fishermen 7. Claims for deposits toward the purchase or rental of items for personal, family or household use, with certain limitations. 8. Certain claims for federal, state, and local taxes.
<u>Trustee in Bankruptcy (the Case Trustee)</u>	Disinterested person appointed by the Office of the United States Trustee. The trustee has

TERM	DEFINITION
	<p>authority to control all assets of the debtor and is responsible for administering the estate. A trustee is always appointed in chapter 7 cases. In chapter 11 cases, a trustee is appointed in cases where the court finds fraud, dishonesty, incompetence, or gross mismanagement by the debtor, or where the appointment of a trustee would be in the best interests of the creditors. If a chapter 11 trustee is appointed, the trustee will manage the debtor's business. In chapter 7 cases, the business is usually closed, but the trustee may operate the business pending liquidation if the court finds that the creditors would be better served by keeping the business open.</p>
<u>U.S. Trustee</u>	<p>The United States Trustee Program is an agency of the United States Department of Justice that is responsible for overseeing the administration of bankruptcy cases and private trustees. The United States Trustee is responsible for the integrity of the system to insure that all the parties, including the attorneys and trustees are doing what they are required by law to do.</p>
<u>Voluntary Bankruptcy</u>	<p>A bankruptcy case in which the debtor files the petition.</p>

ASSIGNMENT FOR THE BENEFIT OF CREDITORS

740.260

Revenue and Taxation Code §6757, 7053, and 7054

Code of Civil Procedures §493.010 et seq., §1204 - §1206, §1800, and §1802

Civil Code §1954.1

1. **An assignment for the benefit of creditors (assignment) is not a court action.** It is a contractual agreement between a debtor (assignor) and a company or individual (assignee) selected to liquidate all assets, and disburse the proceeds for the benefit of creditors.
2. **Assignments are very loosely regulated.** There is no one place in California Law to find information on assignments.
3. **Notice must be given to creditors.** (CCP section 1802).
 - a. The assignor must file, under penalty of perjury, a list of creditors on the day the assignment is entered.
 - b. The assignee has 30 days after the assignment has been accepted to give written notice of the assignment to the creditors.
 - c. The assignee will establish a date by which creditors must file their claims. The date should not be less than 150 days and not greater than 180 days from the date of written notice of creditors.
 - d. If a corporate officer turns the company over to the assignment company without disclosing a debt to the BOE and the BOE is not noticed of the assignment, the BOE can treat the liability as if no assignment has been filed. The BOE should determine if a dual determination should be pursued against the corporate officer.
4. **Priorities of Claim.** Claims are paid in the following order:
 - a. Claims of the United States (31 U.S.C. section 3713).
 - b. Wages (CCP section 1204).
 - c. Employee benefit contributions (CCP section 1204).
 - d. Money placed on deposit for goods and services not delivered (CCP section 1204.5).
 - e. Preferred labor claims (CCP section 1206).
 - f. Amounts due to the BOE (including penalties and interest thereon) – except where a lien or secured interest is superior to any BOE lien or interest. (RTC section 6756).
5. **Account Maintenance**
 - a. An assignee has a right to occupy any business location for up to 90 days as long as it pays the monthly lease amount. After 90 days a landlord can terminate the lease if allowed by contract (Civil Code section 1954.1)
 - b. If an assignee operates a business after the business enters into an assignment, the assignee should have its own permit.

6. Preference Payments

- a. Under state law, if within 90 days of the assignment a creditor received a payment either voluntary or involuntary, the assignee may assert a preference action in court. (CCP section 1800(b))
- b. The assignee may also try to have any liens or attachments removed.
- c. A preference action must be filed within 1 year of the commencement of the assignment.
- d. If the assignee asserts that a payment to the BOE was a preference payment, there are several defenses listed in CCP section 1800(b) that include:
 - 1) The new transfer was intended to be a contemporaneous exchange for new value.
 - 2) The transfer was in payment of a debt incurred during the ordinary course of business, the challenged payment was made in the ordinary course of business and according to ordinary business terms.
 - 3) The transfer constitutes the creation of a statutory lien under RTC section 6757, or the "fixing" of that lien by the subsequent recording of the Notice of State Tax Lien.
 - 4) The payment to a claimant was in exchange for a release of an asserted claim of lien.

**ASSIGNMENT FOR THE BENEFIT OF CREDITORS
(ASSIGNMENT)**

(CONT. 2) 740.260

1) Control of the Account

- a. Day-to-day control of the account is in the hands of the district office or division of PSTD.
- b. SPS handles the monitoring of the assignment case.

2) Status of the Case

- a. Status is only obtainable through communication with the assignment company.
- b. There is no current law that requires the assignment company to provide a disbursement schedule for creditors (in general) showing the proposed distribution of the liquidated funds.
- c. The Board can use RTC sections 7053 and 7054 to request that a disbursement schedule or proposed disbursement be supplied.

PROBATES

740.270

Probate Code (in general), Specifically Probate Code §11420, §9760, §9201, and §9203
Revenue and Taxation Code §6487.1

Probate: Probate is a legal process by which legal title to property of a deceased person (“the decedent”) is transferred from an estate to its beneficiaries by the court. It is designed to ensure the fair distribution of a decedent’s assets and settlement of outstanding debts. If the decedent had a will at the time of death, an executor is named in the will as the individual selected by the decedent to fulfill the instructions set forth in a will. If the decedent did not have a will, an administrator is appointed by the court to handle the affairs of the decedent and distribute property as required by statute.

1. Assets subject to probate:

- a. Assets in the decedent’s name alone.
- b. One-half of each asset registered as community property in the decedent’s name with his or her spouse.
- c. The decedent’s portion or share of an asset where the asset is registered as tenants in common with other people
- d. Assets which are owned by the decedent, but not registered, such as furniture, jewelry, etc.

2. Assets not subject to probate:

- a. Assets held in joint-tenancy.
- b. Assets held in a living trust.
- c. Life insurance and IRA benefits where a beneficiary is named.
- d. Assets passing to the surviving spouse, even if held in the decedent's name alone.
- e. Assets registered by husband and wife as "community property with right of survivorship."

3. Making a Claim

- a. Probate Code section 9201: The personal representative or administrator must make a written request to a public entity creditor. The creditor's time to respond is based on the law of the public entity. For sales and use tax law, see RTC section 6487.1, which provides that a notice of deficiency determination shall be mailed within four months of the written request. Otherwise, pursuant to Probate Code section 9100, a claim must be filed four months after the date letters are first issued to a general personal representative or sixty days after the date notice of administration is delivered to the creditor.
- b. RTC section 6487.1: The BOE has four months from the written request to issue a deficiency determination to the personal representative or administrator.
- c. Probate Code section 9203: If property of the estate is disbursed before the BOE's allowed time to file a claim, we can hold the distributee's (whomever received the funds) liable with costs.
- d. A claim is either Allowed or Rejected by the personal representative (administrator).
- e. The BOE has 90 days to respond to a rejected claim.

4. Account Maintenance

5. Staff must determine the status of a decedent's business, did it close or was there a change in ownership – is a new permit needed?

- a. A sole proprietor who dies should not have a close out date beyond the date of the individual's death.
- b. A partnership should only remain as a partnership if there are two or more remaining partners, otherwise the remaining partner should get a sole proprietor permit.

6. Probate Estate as operator of the business

- a. If the probate estate (i.e. estate administrator) is operating a decedent's business, the estate should get its own permit (ex., The Estate of Emma Lou Pappel, as the taxpayer).

- b. Probate Code section 9760: The personal representative may continue to operate a decedent's business for up to 6 months without a court order. A court order is required after 6 months.
- c. District office staff should request a copy of the death certificate for the file – but this is not a requirement to proceed.

7. Control of the account

- a. Day-to-day control of the account is in the hands of the district office or division of PSTD.
- b. SPS handles the monitoring of the probate case.

8. Status of the case

- a. A probate action is filed in probate court, which in most cases is a separate division of Superior Court. The action is usually commenced in the county in which the debtor died.
- b. Many probate courts have docket information available through the court's website.
- c. SPS can send a letter to the administrator requesting status of the case if unable to access the docket information – or if the information in the docket is sparse.

9. Non-Compliance of an Estate while running a decedent's business

- a. Probate Code section 11420: Any taxes incurred by the Estate would be considered an "expense" of the Estate.
- b. The BOE must use the Attorney General to file a motion to allow the expense – it is not just a regular claim filing (there is no such thing as an expense claim in a probate case).

10. State Tax Liens

- a. A tax lien filed before the date of death remains in effect against the estate and is fully enforceable.
- b. A tax lien filed on a decedent after the death is also a valid lien against the estate of the debtor. If the BOE knows a taxpayer is deceased, a lien should be filed against "The Estate of X."
- c. In cases where the decedent's property was held in joint tenancy, transferred to a living trust, or transferred to a spouse on or before the date of death – a lien filed after death would have no effect.

PROBATES**(CONT. 3) 740.270**

- d. In most cases, BOE's filing of a lien after a probate action has commenced is unlikely to improve BOE's position with respect to payment of its claim and it may hinder efforts by the representative to sell the property.
- e. On the other hand, where a personal representative of an estate incurs a tax liability and fails to pay or there is a risk of additional liens or security interests being recorded against the property (decreasing the likelihood that the BOE will be paid) a lien may be appropriate.
- f. Accordingly, a lien should be filed after a probate action has commenced only after consulting with the Board's Legal Department.

RECEIVERSHIPS**740.280**

Code of Civil Procedures §1204 - §1206 and §564
Revenue and Taxation Code §6756

1. Receivership: The appointment of a person to hold in trust and administer property subject to litigation, settle the affairs of a business involving a public interest, or manage a corporation during reorganization.
 - a. A receiver is appointed by the court in any case in which the court is empowered by law to appoint a receiver. (Code of Civil Procedure section 564)
 - b. A receivership is not always a liquidation proceeding and, therefore, there is not always a disbursement.
2. A receiver can be appointed by the court in the following cases (Code of Civil Procedure section 564):
 - a. By a vendor, partner, or creditor, where it is shown that property or funds are in danger of being lost, removed, or materially injured, or where a party seeks to vacate a fraudulent purchase.
 - b. By a secured lender, where it appears that the property is in danger of being lost, removed, or materially injured (and the property is insufficient to pay the debt).
 - c. By judgment or to enforce a judgment.
 - d. When a corporation is insolvent or has been dissolved.
 - e. In an action of unlawful detainer.
 - f. At the request of either the Office of Statewide Health Planning and Development or the Attorney General.
 - g. In an Assignment for Benefit of Creditors, regarding the assignment of rents to maintain real property.

RECEIVERSHIPS

(CONT. 1) 740.280

3. The receiver is sworn in. The receiver has the power to bring and defend actions in his own name as receiver, keep possession of the property, receive rents, collect debts, make transfers, and generally do such acts respecting the property as the court may authorize.
4. Priorities. Claims are to be paid in the following order:
 - a. Claims of the United States (31 U.S.C. section 3713).
 - b. Wages (CCP section 1204).
 - c. Employee benefit contributions (CCP section 1204).
 - d. Money placed on deposit for goods and services not delivered (CCP section 1204.5).
 - e. Preferred labor claims (CCP section 1206).
 - f. Amounts due to the BOE (including penalties and interest thereon) – except where a lien or secured interest is superior to any BOE lien or interest. (RTC section 6756).
5. Claims in Receiverships. There is no formal timeline to file a claim in a receivership case, however the Board policy is to file the claim within 4 months of the filing if possible.
6. Account Maintenance. If a receiver runs the business, then the receiver should have its own permit. (See CPPM 210.010, *Sellers Permits*).
7. Control of the Account
 - a. Day-to-day control of these accounts remain in the district office or division of PSTD. Status requests and questions regarding the proceedings can be directed to SPS staff.
 - b. SPS staff will maintain the legal case.
8. Status of the Case. Since receiverships are monitored through the court, information regarding the case can be accessed through the Superior Court website, or, if not online, at the court itself.