

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matters of the Administrative Protest)
And Claim for Refund)
Under the Sales and Use Tax Law of:) Account Number SR AC 53-004070
) Case ID's 475764, 515722
GORDON W. KELLEY)
Taxpayer) Stuart, Florida

Type of Liability: Responsible person liability

Liability period: 07/01/00 – 06/30/03

Since we have now concluded that taxpayer is not personally liable pursuant to Revenue and Taxation Code section 6829, there is no longer any amount in dispute.

	<u>Tax</u>	<u>Penalty</u>
As determined	\$354,192.86	\$85,988.60
Post-D&R adjustment	- 24,209.59	- 37,840.27
Post-Board hearing adjustment	<u>-329,983.27</u>	<u>-48,148.33</u>
Balance	<u>\$ 00.00</u>	<u>\$ 00.00</u>

The Board held the hearing in this appeal on October 30, 2013 and allowed 90 days for the Appeals Division to investigate and analyze the additional evidence and arguments presented at the hearing. Based upon that investigation and analysis, we now find that petitioner is not liable pursuant to section 6829 for the unpaid tax liabilities of Southland Fireplaces, Inc. Since we have reversed our position based on the additional evidence and testimony, the final action summary below does not incorporate any of the Board hearing summary. However, for historical reference, we have included the Board hearing summary after the final action summary.

RESOLVED ISSUE

The issue in this case is whether taxpayer is personally liable under section 6829 for the unpaid tax liabilities of Southland Fireplaces, Inc. (SR AC 97-525550) (Southland) for the period July 1, 2000, through June 30, 2003. There is no dispute that the first three elements of liability under section 6829 are met (Southland terminated its business operations; it consumed tangible personal property; and taxpayer was one of the persons responsible for Southland's tax compliance when the property

1 was consumed). Thus, the only remaining disputed issue in this appeal involves the fourth element of
2 liability under section 6829, willfulness.

3 Before turning to the facts of this appeal, we note that this matter raises an issue of first
4 impression for the Board regarding the timing of the knowledge component of the willfulness element.
5 More specifically, this case raises an issue regarding the timing of when a potentially responsible
6 person must know of the unpaid tax liability in order to be held liable under Section 6829. A bit of
7 background is necessary to understand and resolve this issue.

8 Based on our interpretation of the statute and California Code of Regulations, title 18, section
9 (Regulation) 1702.5, we have long concluded that willfulness consists of three components: (1)
10 knowledge of the unpaid tax liability; (2) the authority to cause the taxes to be paid; and (3) available
11 funds with which to pay the taxes. Neither the statute nor Regulation 1702.5 specifies any time by
12 which an otherwise responsible person must acquire knowledge of the unpaid tax in order to be held
13 liable. Until approximately May 2012, we traditionally interpreted the willfulness requirement to
14 require knowledge of the unpaid tax liability prior to or at the time of the date the taxes were due. In
15 other words, if an otherwise responsible person did not acquire actual or constructive knowledge of the
16 unpaid tax liability until after the date such taxes were due, we found that such person was not
17 personally liable under section 6829.

18 However, in approximately May 2012, we reexamined the actual language of section 6829 and
19 Regulation 1705.2. In so doing, we discerned a requirement in the regulation of which we had
20 previously been unaware: in order to be held liable under section 6829, a person must have been
21 responsible for tax compliance *when* the sales were made or property consumed. (Cal. Code Regs., tit.
22 18, § 1702.5, subd. (a).) Accordingly, since May of 2012 we have applied (and the Board has
23 affirmed) a narrower interpretation of liability under section 6829, such that a person must be
24 responsible for tax compliance *both* when the tax liability was incurred (i.e., when sales were made or
25 property consumed) *and* when the tax was due.

26 Our re-reading of the statute and regulation also resulted in a reconsideration of when a
27 responsible person must know that taxes were not paid. In rare cases, such a person may not acquire
28 actual knowledge of the liability until after the taxes are due (e.g., a person may not acquire actual or

1 constructive knowledge of an unpaid use tax liability until the completion of an audit or the issuance of
2 a field billing order, which always occurs after the due date of the applicable tax). We turn again to the
3 actual language of the regulation, which in relevant part says that “Any responsible person who
4 willfully fails to pay or cause to be paid ...*any taxes due* ... shall be personally liable” for any unpaid
5 taxes and interest and penalties on those taxes. (Cal. Code Regs., tit. 18, § 1702.5, subd. (a), emphasis
6 added.) In other words, the plain language of the regulation only requires that the otherwise
7 responsible person must have willfully failed to pay the unpaid taxes that remain due on or after the
8 termination of the business operations, and does not limit such liability only to the moment the taxes
9 became due. We believe that to hold to the contrary is to allow an otherwise responsible person who
10 could have paid the unpaid tax liability once he or she learned of it, to escape liability, thus defeating
11 the purpose of section 6829 and Regulation 1702.5. (We note that, for personal liability to attach, the
12 responsible person must have still had the authority and the means (funds available) to pay the taxes at
13 the time he or she acquired the requisite knowledge.) Accordingly, we believe that an otherwise
14 responsible person who learns of an unpaid tax liability while funds remain available to pay it, but
15 elects not to pay it, wilfully fails to do so and is therefore liable under section 6829 (assuming all other
16 elements have been met).

17 Again, this issue is a matter of first impression before the Board, and it is a matter of statutory
18 and regulatory interpretation. The Board’s action on this matter will provide guidance and direction to
19 staff on this issue.

20 Turning to the material facts of this case, Southland operated as a construction contractor
21 furnishing and installing garage doors and fireplace units from July 1999 through September 2005. At
22 the time its business terminated, Southland had unpaid use tax liabilities established in an audit. As
23 herein relevant, we had concluded that petitioner wilfully failed to pay Southland’s tax liability
24 because we found that petitioner knew or must have known that use tax applied to Southland’s
25 consumption of materials in lump-sum construction contracts and that he acquired actual knowledge of
26 Southland’s liability as a result of Southland’s audit at issue (i.e., after the taxes were due). Based on
27 taxpayer’s presentation at the hearing, we are persuaded that he did not have actual or constructive
28 knowledge of the liability until the audit was completed (i.e., after the taxes at issue were due).

--BOARD HEARING SUMMARY--**UNRESOLVED ISSUES**

Issue 1: Whether taxpayer is personally liable as a responsible person for the unpaid liabilities of Southland Fireplaces, Inc. pursuant to Revenue and Taxation Code section 6829. With the exception of sales tax liability incurred by Southland Fireplaces, Inc., for which it did not collect tax reimbursement (as explained under “Other Matters”), we conclude taxpayer is personally liable.

Southland Fireplaces, Inc. (Southland) (SR AC 97-525550) operated as a construction contractor furnishing and installing garage doors and fireplace units from July 1999 through September 2005. At the time its business terminated, Southland had unpaid liabilities related to an audit. During the audit period, Southland billed its contracts on a lump sum basis, purchased materials and fixtures without payment of tax by providing resale certificates to vendors, and reported no tax liability. The Department concluded that taxpayer was personally liable for Southland’s sales and use tax debts pursuant to section 6829.¹

Taxpayer concedes that Southland ceased business operations on September 30, 2005, and that he was a person responsible for Southland’s sales and use tax compliance. Taxpayer asserts, however, that the two remaining conditions for imposing personal liability on him have not been satisfied, that Southland collected sales tax reimbursement with respect to retail sales and that the failure to pay the taxes was willful. As explained under “Other Matters,” an adjustment has been recommended for sales tax liabilities incurred by Southland for which it did not collect tax reimbursement from its customers. However, the majority of Southland’s liability represents use tax due on the consumption of materials in construction contracts. Southland was the consumer of materials it used in the completion of lump sum construction contracts, but failed to report and pay that use tax. Since that use tax is the tax remaining at issue, and this element of section 6829 is satisfied where the applicable tax is use tax owed on the primary taxpayer’s consumption of tangible personal property, we conclude that the first

¹ The Department also found that Terry Eaves and Greg Keeton were personally liable as responsible persons pursuant to section 6829. Terry Eaves has filed an administrative protest (case ID 475767), which is scheduled for Board hearing on the same calendar as this matter. Mr. Keeton has not protested the determination issued to him.

1 disputed element of section 6829 liability has been satisfied with respect to the amounts of tax
2 remaining in the determination after the adjustment recommended herein.

3 With respect to willfulness, taxpayer contends that his failure to pay Southland's tax was not
4 willful because he relied on the advice of Norman Keef, whom taxpayer believed to be a Certified
5 Public Accountant (CPA) and who stated that no sales or use taxes were required to be paid in light of
6 the nature of Southland's business. In support, taxpayer has provided a declaration describing such
7 reliance, as well as a business card and other evidence that indicate Mr. Keef led taxpayer to believe he
8 was a CPA. Also, taxpayer cites various court cases which hold that reliance on the advice of tax
9 professionals negates the willfulness element under Internal Revenue Code section 6672.

10 The willfulness requirement for imposing liability under section 6829 is satisfied where the
11 failure to pay or to cause to be paid the taxes due was the result of an intentional, conscious, and
12 voluntary course of action (even if without a bad purpose or evil motive). A person is regarded as
13 having willfully failed to pay taxes or to cause them to be paid where he or she had knowledge that the
14 taxes were not being paid and had the authority and ability to pay the taxes or to cause them to be paid,
15 but failed to do so.

16 When Southland applied for its seller's permit signed by taxpayer as manager, the Department
17 provided Southland copies of several regulations and Board publications, including California Code of
18 Regulations, title 18, section 1521 and Board Publication 9, "Tax Tips for Construction and Building
19 Contractors." These publications clearly explain that construction contractors billing on a lump sum
20 basis, such as Southland, are consumers of materials and owe use tax on cost if not paying tax or tax
21 reimbursement to their vendors, as here. Taxpayer signed the seller's permit application, and we
22 assume that taxpayer read the publications provided. We note in this regard that taxpayer did not
23 attend the appeals conference, so we were unable to judge his credibility. We note also that taxpayer
24 had been vice-president of Advanced Fireplaces, a construction contractor furnishing and installing
25 prefabricated fireplaces from August 1983 through March 1992 (during an audit, the Department found
26 that Advanced Fireplaces included the cost of materials in its reported taxable measure). We find that,
27 based on the evidence presented, taxpayer was aware that Southland incurred use tax liability when it
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1 consumed materials it purchased for resale to perform construction contracts. Taxpayer's citations to
2 cases interpreting federal law are not relevant here.

3 There is ample evidence that taxpayer had authority to cause the taxes due to be paid, and he
4 does not dispute that finding. Regarding whether Southland had sufficient funds to pay the taxes due,
5 we note that during the applicable periods, Southland was making substantial sales, as evidenced by its
6 reported gross receipts, and it paid wages totaling \$3,352,855 during the years 2001 through 2005. We
7 find Southland had funds available to pay its tax liability, but its management chose to pay other
8 creditors instead. In summary, we conclude that all conditions have been satisfied for imposing
9 personal liability on taxpayer under section 6829 for the outstanding tax liabilities of Southland.

10 Taxpayer has filed claims for refund for payments totaling \$11,197.00. Since we find that
11 taxpayer is personally liable under section 6829 and that no further adjustments are warranted, and
12 since the amount paid does not exceed the amount due, we recommend that the claims for refund be
13 denied.

14 **Issue 2:** Whether Southland was negligent. We conclude that it was.

15 The Department imposed the negligence penalty in the audit of Southland because the audit
16 disclosed a taxable measure of \$6,181,239, and Southland had paid no tax liability for the audit period.
17 Taxpayer disputes the penalty on the basis that Southland's failure to report tax was the result of
18 reliance on erroneous advice received from Mr. Keef.

19 We find that Southland's failure to report any of the tax it owed, measured by over \$6 million,
20 is a particularly egregious understatement, which cannot be obviated by the alleged reliance on
21 Mr. Keef's advice. We note also our finding that taxpayer did actually know that use tax had been
22 incurred, but not paid. We find that there is ample evidence of negligence and that the penalty was
23 properly applied.

24 **RESOLVED ISSUE**

25 Since Southland did not timely pay the determination or file a petition for redetermination, a
26 finality penalty was applied, which was included in the determination issued to taxpayer. After the
27 adjustments recommended herein, the amount of the finality penalty included in the determination
28 against taxpayer is \$32,998.33. Taxpayer has filed a request for relief of the finality penalty. We find

1 that Southland's failure to timely pay the determination was the result of reasonable cause because, by
2 the time the determination became final, Southland had filed bankruptcy, no longer had control over its
3 assets, and thus lacked the ability to pay the liability. Accordingly, we recommend relief of the finality
4 penalty if the remaining tax liability is paid in full within 30 days of the mailing of the notice of final
5 decision in this appeal.

6 **OTHER MATTERS**

7 When this matter was scheduled for hearing in October 2012, the Department requested that it
8 be deferred for further review. Specifically, the Department was concerned that the amounts of tax
9 included in the determination against taxpayer might include sales tax for which Southland had not
10 collected tax reimbursement from its customers.

11 The Department found that Southland had billed general contractors on a lump-sum basis. The
12 Department determined that Southland was a consumer of materials used in construction contracts and
13 assessed use tax based on the purchase price of those materials. However, the lump sum contracts also
14 included sales of garage door opener and transmitter units (fixtures), for which Southland was liable
15 for sales tax. Since Southland did not collect tax reimbursement from the general contractors on its
16 sales of garage door opener and transmitter units, the Department concluded that the related sales tax
17 liability incurred by Southland should not be included in the determination against taxpayer, since, for
18 those transactions, all four requisite elements for holding taxpayer personally liable have not been met.
19 Accordingly, the Department established an audited amount of sales of fixtures of \$294,340 included
20 in the measure of tax in the audit of Southland, and recommended a reduction of \$24,209.59 in the
21 amount of tax determined against taxpayer.

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23 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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