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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **JOHN M. KLING**) Case No. 847081
13)
14)

	<u>Taxable</u>	<u>Deficiencies</u>	
	<u>Years Ending</u>	<u>Additional Tax</u>	<u>Penalties</u>
	March 31, 2004	\$262.19 ¹	
	March 31, 2005	\$347,752.81	\$44,173.74
	March 31, 2006	\$1,536.38	\$240.35
	March 31, 2007	\$1,446.39	\$255.04
	March 31, 2008	\$1,343.24	\$258.84
	March 31, 2009	\$872.19	\$244.05
	March 31, 2010	\$1,192.62	\$233.07

22 Representing the Parties:

23 For Appellant: A. Lavar Taylor, Attorney at Law

24 For Franchise Tax Board: Maria Brosterhous, Tax Counsel III

26 ¹ The Notice of Proposed Assessment (NPA) for Taxable Year Ending March 31, 2004, stated an additional tax amount of
27 \$3,222 and penalties in the amount of \$1,326.47. The Notice of Action (NOA) affirmed the NPA but prior to issuing the
28 NOA respondent applied payments made by appellant in 2012. The NOA stated the amount of \$262.19 as the total liability
for additional tax, penalties, fees and interest. At the hearing, respondent should be prepared to explain the portion of that
amount, if any, that represents penalties.

1 QUESTION: (1) Whether appellant has established error in the determination of respondent Franchise
2 Tax Board that appellant was properly assessed as a transferee for the liabilities of
3 taxpayer/transferor, Fire X-Tinguisher Service Co., Inc. (Fire X) for the tax years
4 March 31, 2004 through March 31, 2010.

5 HEARING SUMMARY

6 Factual and Procedural Background

7 Appellant is the president of Fire X which was incorporated in California in 1986.
8 According to the records of the Office of the California Secretary of State, Fire X's filing registration
9 with that office was suspended by respondent as of August 1, 2007. On October 12, 2010, Fire X filed
10 untimely Form 100 returns for taxable years ending (TYEs) March 2004 through March 2007 and on
11 March 15, 2011 filed untimely Form 100 returns for TYEs March 2008 and March 2009 and on
12 October 5, 2011 filed an untimely Form 100 return for TYE March 2010. The returns for TYE March
13 2004 reported tax of \$3,222 and for TYE March 2005 reported tax of \$163,104. The returns for TYEs
14 March 2006 through March 2010 reported the \$800 minimum tax. Each of the returns lists appellant as
15 the sole shareholder. (Resp. Op. Br., pp. 1-2, exhs. A, D, E, F, G and I.)

16 Fire X's return for TYE March 2009 reported a loan to shareholder in the amount of
17 \$633,429. A document dated March 31, 2009, states as follows: "This is a memorialized agreement
18 between John Kling and [Fire X] formerly known as Complete Fire Protection, Inc. In consideration of
19 \$663,429, John Kling agrees to assume debts of Fire X totaling \$974,943." (hereinafter, "assumption
20 agreement") The assumption agreement is signed by appellant on behalf of Fire X and by appellant as
21 an individual. Another document titled "Minutes of Special Meeting of Board of Directors" of Fire X
22 recites that the special meeting was held on April 10, 2009 at which only appellant, the sole director of
23 the corporation, was present and acting as Chairman and Secretary. The minutes noted that appellant is
24 the guarantor on a loan from Main Credit Corporation to Fire X and that the balance of the Main Credit
25 Corporation loan exceeds the balance on the loan to appellant. The Board adopted a resolution whereby
26 appellant would repay the Main Credit Corporation loan on behalf Fire X and in exchange Fire X
27 would credit the full amount of the shareholder loan to appellant. (Resp. Op. Br., p. 1, exhs. B and C.)

28 Fire X submitted payments as follows: For TYE 2004, four payments totaling \$4,235.00

1 received in 2012 and one payment of \$2,559.75 received in 2013, for TYE 2005, one payment of
2 \$1,441.37 received in 2013 and for TYE 2009, one payment in 2013 and nine were received in 2014 for
3 a total of \$1,100.00. On May 9, 2013, respondent issued Notices of Proposed Assessment (NPAs) for
4 TYE March 31, 2004 through TYE March 31, 2011 to appellant as a transferee of Fire X.² Appellant
5 filed timely protests and respondent sustained the NPAs in Notices of Action (NOAs) dated July 23,
6 2014. Appellant then filed this timely appeal. (Resp. Op. Br., p. 2, exhs. J - X.)

7 Contentions

8 Appellant

9 In the appeal letter, appellant states that respondent cites Revenue and Taxation Code
10 section 19071 and Civil Code sections 3439 to 3449 which govern fraudulent transfers. Appellant states
11 that respondent alleges fraud but that respondent bears the burden of proving fraudulent conduct to of
12 proving that such conduct was intentional. Appellant further states that he was forced to close his
13 business because the Contractors State License Board would not renew his license as the corporation
14 was suspended by the Office of the Secretary of State. Appellant states that the corporation was placed
15 in suspended status because respondent reported that Fire X failed to file tax returns. Appellant asserts
16 an individual named Robert Martin “had a duty” to file the returns but failed to do so. Appellant also
17 states that he attempted to merge the business into a newly formed corporation but was denied by the
18 Office of the Secretary of State. (Appeal Letter, pp. 1-2.)

19 Appellant takes issue with respondent’s position that appellant’s agreement to act as
20 guarantor for the Main Credit Corporation loan is not a defense to transferee liability. Contrary to
21 respondent’s position that the tax liability and the loan obligation are two separate unrelated
22 transactions, appellant contends that they are related transaction in that Main Credit Corporation held a
23 senior lien position and thus if appellant had repaid the \$663,429 to Fire X, respondent could not have
24 collected that amount. Appellant concludes that “the fact that the money was not deposited into a
25 Fire X account and then paid to Main Credit is irrelevant. The end result is the same.” Appellant adds
26 that the revenues he “earned” after “the closure of Fire X” went directly from the customers to
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28 ² Respondent states in the opening brief that the NPA and a Notice of Action for TYE March 31, 2011 have been withdrawn.

1 Main Credit and he did not issue any checks to Main Credit as requested by respondent. Appellant also
2 contends that the limitations period for respondent to issue assessments had expired so that respondent
3 was barred from imposing transferee liability. Appellant also describes the attachments to the Appeal
4 Letter including a summary of “the sale [to Beacon] that has been reported on the return with the
5 payments received each year”, a statement of cash flows for TYE March 31, 2005 through TYE
6 March 31, 2009, and a copy of the Main Credit statement showing the loan balance of \$974,942.80 and
7 a statement dated October 31, 2011 showing a balance of \$164,166.98. (Appeal Letter, p. 2.)

8 In a reply brief, appellant argues that in its opening brief respondent’s sole argument to
9 support its position that appellant is liable as a transferee is that Fire X transferred an asset to appellant
10 without fair consideration which resulted in the insolvency of Fire X. Appellant contends that
11 respondent has not presented sufficient supporting evidence and that the available evidence shows that
12 appellant provided fair consideration. Appellant cites R&TC sections 19071 and 19073, subdivision
13 (a), and the *Appeal of Howard Zubkoff and Michael Potash, Assumers and/or Transferees of Ralite*
14 *Lamp Corporation*, (90-SBE-004), decided April 30, 1990 (*Appeal of Zubkoff*) in which this Board held
15 the California provisions for transferee liability are substantially similar to Internal Revenue Code
16 section 6901 so that federal authority interpreting IRC section 6901 is highly persuasive in the
17 application of those R&TC provisions. Appellant further states that the applicable law for determining
18 transferee liability is the law of the state in which the transfer occurred so that California law governing
19 fraudulent transfers is applicable here. (App. Reply Br., pp. 2-3.)

20 Appellant states that California has adopted the Uniform Fraudulent Transfer Act in
21 Civil Code (UFTA) sections 3439 through 3439.12 and contends that respondent has failed to cite the
22 provision under which transferee liability was imposed on appellant. Thus, appellant concludes that
23 respondent has failed to meet its burden of proof. Appellant asserts that respondent “apparently relies”
24 on Civ. Code section 3439.15 but that a party seeking to establish that a transfer is constructively
25 fraudulent under this provision “must carry the heavier burden of proving fraud by the appropriate
26 standard which a preponderance of the evidence[.]” citing *Mejia v. Reed* (2002) 97 Cal.App.4th 277, fn.

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28 ///

1 27.³

2 Appellant asserts that respondent must prove all the following elements to establish that any
3 transfer from Fire X to appellant was constructively fraudulent:

4 (a) Fire X transferred property to appellant.

5 (b) Fire X did not receive reasonably equivalent value in exchange for the transfer.

6 (c) At the time of the transfer and at the time transferee liability was asserted, Fire X was liable for
7 the tax.

8 (d) The transfer was made after the liability accrued regardless of whether tax was assessed.

9 (e) Fire X was insolvent at the time of the transfer or became insolvent as a result of the transfer.

10 Appellant cites the *Appeal of Firooz Farmanfarmai, Transferee of Parivash Varzi*, (87-SBE-029,
11 decided on April 7, 1987, as support for his contention that failure to prove any of these elements
12 “compels a finding” that a transfer was not constructively fraudulent. (App. Reply Br., pp. 3-4.)

13 Appellant states that he does not dispute that respondent has proven elements (a), (c),
14 and (d) but contends that respondent has not proven that the transfer was not in exchange for
15 reasonably equivalent value and that Fire X was insolvent. Appellant contends that respondent
16 “erroneously states” that the transfer must be for “less than full and adequate consideration.” Appellant
17 cites *Crumpton v. Stephens* (11th Cir. 2013) 715 F.3d 1251, in which the court held that “a corporate
18 debtor received reasonably equivalent value for a cash dividend to a shareholder where the shareholder
19 consented to an S corporation election under which he would be personally liable for tax on a portion of
20 the corporation’s income.” Appellant repeats the facts set forth above regarding appellant’s loan
21 repayment obligation to Fire X, Fire X’s debt obligation to Main Credit and the agreement by which
22 appellant assumed liability for the Main Credit debt on behalf of Fire X. (App. Reply Br., pp. 5-6.)

23 Appellant contends that respondent “misleadingly states” that a portion of the liabilities
24 that appellant assumed are the state taxes at issue here and that he only assumed Fire X’s debt
25 obligation to Main Credit. Appellant further contends that he gave reasonably equivalent value by
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28 ³ The cited footnote refers to the burden of proving actual fraud, rather than constructive fraud, based on a transfer for inadequate consideration under the UFTA. In *Mejia v. Reed* (2003) 31 Cal. 4th 657, the California Supreme Court reversed and remanded the decision of the appellate court finding that for purposes of summary adjudication there was no triable issue of fact with respect to constructive fraud but that actual fraud remained a triable issue for decision.

1 agreeing to “act to repay” the \$974,943 debt Fire X owed to Main Credit in exchange for Fire X
2 forgiving his \$663,429 debt, which reduced Fire X’s debt by an amount in excess of appellant’s loan.
3 Appellant asserts that, although Fire X remained liable as the primary obligor, appellant’s agreement
4 constituted consideration for reasonably equivalent value. By acting as guarantor of the Fire X debt to
5 Main Credit, appellant asserts under Civ. Code sec. 1605 he provided consideration that was reasonably
6 equivalent value to the debt he owed to Fire X. Appellant cites *Beatrice Co. State Bd. of Equalization*
7 (1993) 6 Cal.4th 767 (*Beatrice Co.*), for his position that if “[a]n agreement to assume liabilities . . . [is]
8 supported by consideration, it is enforceable notwithstanding the continuing primary liability of the
9 promisee for the same obligation.” The court further held that “[t]his right to compel another to fulfill
10 the promisee’s obligations arises from the assumption agreement . . . [which] has value equal to the cost
11 to the promisee of paying its debts or fulfilling its obligations. This value constitutes consideration
12 within the meaning of section 6006 and Civil Code section 1605.” (*Id.* at 776.)

13 Appellant states that prior to the assumption of Fire X’s debt obligation to Main Credit,
14 appellant was “only a guarantor of the obligation” and could not be required to pay Main Credit unless
15 Fire X defaulted. Appellant further states that if appellant had paid Main Credit he would have an
16 enforceable right to be reimbursed by Fire X and cites Civ. Code section 2787 and 2848. Appellant
17 asserts that this relationship changed when appellant assumed the debt obligation to Main Credit in that
18 Main Credit could pursue appellant as the primary obligor on the debt without a Fire X default and to
19 the extent Fire X paid the debt it could recover damages from appellant. As a result, appellant contends
20 that Fire X received consideration in an amount equal to the Main Credit debt which was more than
21 appellant’s debt to Fire X and thus a reasonably equivalent value. (App. Reply Br., p. 9.)

22 Appellant states that respondent is unclear about the date of the transfer but states that it
23 was in approximately March of 2009. Appellant asserts that if the transfer occurred in March of 2009
24 then Fire X was not rendered insolvent based on the corporation’s balance sheet for the TYE March 31,
25 2009 which shows that assets totaled \$2,163,992 and liabilities totaled \$1,038,028. Appellant further
26 asserts that his assumption of the debt obligation to Main Credit debt reduced Fire X’s liabilities to
27 \$63,085. Appellant also states that if the transfer occurred in March of 2010, it did not render Fire X
28 insolvent and the transfer effectively increased the solvency of the corporation. (App. Reply Br., pp. 9-

1 10.)

2 Respondent

3 Respondent cites R&TC section 19071 which provides that respondent may assess a
4 transferee of property either at law or in equity for the liability of a taxpayer-transferor. Respondent
5 states that to establish transferee liability in equity respondent has burden of proof to establish the
6 following elements: (1) the taxpayer-transferor transferred property to the transferee for less than full
7 and adequate consideration; (2) at the time of the transfer and at the time transferee liability is asserted,
8 the taxpayer-transferor was liable for the tax; (3) the transfer was made after the liability for the tax
9 accrued, whether or not the tax was actually assessed at the time of the transfer; (4) the taxpayer-
10 transferor was insolvent at the time of the transfer or the transfer left the taxpayer-transferor insolvent;
11 and (5) respondent has exhausted all reasonable remedies against the taxpayer-transferor. As support,
12 respondent cites R&TC section 19073, Civ. Code sections 3439 – 3429.12 and the *Appeal of Zubkoff*,
13 *supra*.

14 With respect to each element, respondent makes the following arguments:

- 15 1. In the *Appeal of Zubkoff* this Board cited Civ. Code section 3439.04 which provides in part that
16 “every conveyance made . . . by a person who is or will be thereby rendered insolvent is
17 fraudulent as to creditors without regard to his actual intent if the conveyance is made . . .
18 without a fair consideration.” Without the ability to review the loan agreement between Fire X
19 and appellant it is not clear whether Fire X received any consideration in return for the loan.
20 The document dated March 31, 2009, was signed only by appellant and was not witnessed or
21 notarized. Thus, this document is not sufficient evidence of adequate consideration and
22 appellant has not provided any evidence that he paid Fire X’s liabilities, a portion of which are
23 the state taxes at issue here. (Resp. Op. Br., pp. 3-4.)
- 24 2. The transfer from Fire X occurred in approximately March of 2009 and Fire X was liable for
25 TYE March 2004 through TYE March 2009 at the time of the transfer. Additionally, the
26 transfer occurred during the TYE March 2010 and Fire X was also liable for the TYE March
27 2010 tax assessment. Thus, Fire X as the taxpayer-transferor was liable for the taxes for all
28 years at the time of the transfer. (Resp. Op. Br., p. 4.)

- 1 3. The loan from Fire X to appellant occurred in approximately March of 2009 and because
2 liabilities accrue during an entity's accounting period and the transfer occurred during TYE
3 March 2010, the liabilities for TYE March 2004 through TYE March 2010 had accrued at the
4 time of the transfer. (Resp. Op. Br., p. 4.)
- 5 4. For purposes of transferee liability, insolvency may be determined by the provisions of the
6 UFTA which provides under Civ. Code sec. 3439.02, subdivisions (a) and (c), in relevant part,
7 that "[a] debtor is insolvent if, at fair valuation, the sum of the debtor's debts is greater than all
8 of the debtor's assets . . ." and "[a] debtor who is generally not paying his or her debts as they
9 become due is presumed to be insolvent." As of March 30, 2009, Fire X had the following
10 liabilities: the Main Credit loan obligation of \$974,943, a state tax lien of \$34,140.40 for TYE
11 2005, and corporate tax liabilities for TYE March 2004 through TYE March 2008 at the time of
12 the transfer of \$663,429 to appellant. As reported on Fire X's TYE March 2009 return, Fire X's
13 assets were equal to the amount of its liabilities and its net income of \$210,546. When the tax
14 liabilities are taken into account, Fire X was insolvent at the time of the transfer to appellant.
15 (Resp. Op. Br., p. 5.)
- 16 5. Respondent followed normal collection procedures, including notices, withholding orders filed
17 with Orange County on July 3, 2008 and July 31, 2008, and a state tax lien filed June 3, 2008
18 against appellant. In addition, there is an exception to the exhaustion of reasonable remedies
19 requirement when it is shown that it would be futile to take such steps against an insolvent
20 transferor, as in this case, Fire X became insolvent. (Resp. Op. Br., pp. 5-6.)

21 Respondent asserts that the NPAs were timely issued to appellant. Respondent states
22 that R&TC section 19057 provides that a deficiency assessment is timely if issued within four years of
23 the actual date of filing of the return. In addition, R&TC section 19074, subdivision (a) provides an
24 additional year to issue an assessment against the transferee beyond the expiration of the statute of
25 limitations for assessment of the taxpayer. Here, Fire X did not timely files returns for TYE March
26 2004 through TYE March 2010, and pursuant to R&TC section 19087 the statute of limitations for
27 making deficiency assessments remained open for those years. For TYE March 2004 through TYE
28 March 2007, the four-year limitations period under R&TC section 19057 commenced on October 12,

1 2010, the date the returns for those years were filed, and that period was extended by one year for
2 assessment against a transferee under R&TC section 19074, subdivision (a). Thus, the limitations
3 period for those years expired on October 12, 2015. The returns for TYE March 2008 and TYE
4 March 2009 were filed on March 15, 2011 and the returns for TYE March 2010 and TYE March 2011
5 were filed on October 15, 2011 and, thus, the limitations periods for assessment of transferee liability
6 expires on March 15, 2016 and October 15, 2016, respectively. Thus, the NPAs issued to appellant on
7 May 9, 2013 were timely. (Resp. Op. Br., p. 6.)

8 Respondent disputes appellant's argument that respondent is required to prove
9 fraudulent conduct and that appellant's actions were intentional. Respondent states that R&TC section
10 19701 provides that respondent may assess a transferee of property either at law or in equity for the
11 liability of the taxpayer-transferor and such liability in equity is based on the law of fraudulent
12 conveyances. Respondent asserts that it is only required to prove the five elements set forth above and
13 has done so. Finally, respondent states that appellant asserts that he was the personal guarantor of
14 Fire X's liability to Main Credit and paid back the loan made to him by transferring those funds to
15 Main Credit. As a result, respondent states that appellant argues that he should not be held responsible
16 as the transferee for Fire X's deficiency assessments. Respondent also states that appellant further
17 argues that Main Credit was in a more senior lien position than respondent, so that even if appellant had
18 paid the funds to Fire X, Main Credit would have received them as a priority creditor. Respondent
19 contends that appellant fails to recognize that by accepting the loan under those terms, "specifically
20 after significant tax liabilities were accrued with respondent," appellant also accepted transferee
21 liability under R&TC section 19701. (Resp. Op. Br., pp. 6-7.)

22 In a reply brief, respondent states that appellant argues that the proper standard as to
23 consideration for the exchange at issue is "reasonably equivalent." Respondent points to the standard
24 articulated by this Board in *Appeal of Zubkoff*, which is the leading case and controlling authority, as
25 "less than full and adequate consideration" but asserts that, regardless of the standard, appellant has not
26 demonstrated that any consideration has been provided for this exchange. Respondent states that Fire X
27 loaned appellant \$663,429 and appellant has provided a document that he signed and witnessed stating
28 that he agreed to assume Fire X's debt in the amount of \$974,943. However, respondent notes that the

1 document makes no reference to any consideration for this exchange. Respondent states that appellant
2 appears to argue that the assumption of Fire X's debts was the sole consideration but appellant has not
3 provided any evidence that he made those payments and thus has not proven any consideration was
4 given. (Resp. Reply Br., p. 2.)

5 Respondent also states that appellant's argument that Fire X was not insolvent as of
6 TYE March 31, 2009, is based on the balance sheet provided with the return for that tax year showing
7 liabilities of \$1,038,028, with a reduction of the \$974,943 debt obligation assumed by appellant for net
8 liabilities of \$63,085. Respondent contends that the tax liabilities are not reported on the balance sheet
9 and those amounts must be taken into account for the purpose of determining insolvency. Respondent
10 states that at the time of the transfer Fire X had accrued unpaid federal and California tax liabilities for
11 TYE March 31, 2004 through TYE March 31, 2009 that were not reported on the returns for TYE
12 March 31, 2009 or TYE March 31, 2010, which totaled \$7,633,199.25 for federal tax liability and
13 \$354,405.92 for California tax liability. Respondent notes that Fire X reported assets of \$2,163,992 for
14 the TYE March 31, 2009 and appellant argues Fire X was not insolvent at the time of the transfer in
15 April of 2009. However, respondent contends that appellant fails to account for \$798,605.17 in unpaid
16 tax liabilities, not including penalties and interest, which shows that Fire X was clearly insolvent at that
17 time. (Resp. Reply Br., pp. 2-3.)

18 Appellant's Additional Brief

19 In his additional brief, appellant argues respondent "effectively concedes or
20 acknowledges" that this appeal is governed by *Beatrice Co.*, *supra*, 6 Cal.4th 767, that Civ. Code
21 section 3439.05 provides a transfer is not fraudulent if "the transferor received reasonably equivalent
22 value for what was transferred" and that appellant "personally assumed" the debt of Fire X in the
23 amount of \$974,943. Based on *Beatrice Co.*, appellant argues that Fire X received adequate
24 consideration for crediting the loan made to appellant. Appellant asserts that respondent appears to
25 argue that the assumption of a primary obligation to repay Fire X's loan is not the reasonably
26 equivalent value of crediting appellant's loan from Fire X. Appellant further asserts that *Beatrice Co.*
27 does not provide support for this argument but rather supports appellant's position. (App. Add'l Br., pp.
28 1-2.)

1 Appellant contends that respondent has not presented any case law to contradict cases
2 such as *Crumpton v. Stephens* (11th Cir. 2013) 715 F.3d 1251, in which the court held that a
3 corporation received “reasonably equivalent value” for a cash dividend to a shareholder in 2006 where
4 the shareholders’ agreement executed in 1991 provided that if the corporation ever made a Subchapter
5 S corporation election and a shareholder was thereby liable for taxes on a portion of the corporation’s
6 income the corporation would pay to the shareholder an annual dividend in an amount equal to that tax
7 liability. Appellant further contends that respondent has not met its “heavy” burden of proof to establish
8 transferee liability by merely asserting that appellant has not provided evidence on a particular point.
9 Appellant asserts that “respondent loses” if there are any “deficiencies in the evidence” because
10 respondent has the burden of proof. Appellant concludes that the evidence in the record establishes that
11 Fire X received reasonably equivalent value for crediting the loan made to appellant and respondent has
12 not provided evidence to the contrary. (App. Add’l Br., pp. 2-3.)

13 Applicable Law

14 Statute of Limitations

15 R&TC section 19057, subdivision (a), provides that, in general, an NPA must be mailed
16 to a taxpayer within four years after its return was filed. R&TC section 19067, subdivision (a),
17 provides for an extension of time for issuing the NPA beyond the four-year period when “prior to the
18 expiration of the time prescribed for the mailing of the notice of a proposed deficiency assessment, the
19 taxpayer consents in writing to an assessment after that time.” R&TC section 19074, subdivision (a),
20 provides, in pertinent part, that the period of limitation for the assessment of the liability of the initial
21 transferee of the property of the taxpayer shall be one year after the expiration of the period of
22 limitation for the assessment against the taxpayer.

23 Transferee Liability

24 R&TC sections 19071 and 19073 authorize the assessment of tax against a taxpayer who
25 is the transferee of the tax liability of another taxpayer. The law of the state where the transfer occurred
26 governs. (*Fibel v. Commissioner* (1965) 44 T.C. 647, 657.) IRC section 6901, the federal equivalent of
27 these Revenue and Taxation Code statutes, provides that a transferee includes, among other actors, a
28 distributee. Transferee liability does not impose a new tax liability, but merely provides an alternative

1 means to enforce an existing liability. The liability of a transferee may be enforced either at law or in
2 equity.⁴ (*Appeal of Zubkoff*.) Regardless of whether the enforcement is sought under law or in equity,
3 there are two fundamental elements to transferee liability: (1) there must be a transfer of the taxpayer's
4 property to a third-party transferee; and (2) the taxpayer-transferor must be liable for the tax at the time
5 of the transfer and at the time the transferee liability is asserted.

6 Transferee liability in equity is based upon the law of fraudulent conveyances. (*Appeal*
7 *of Zubkoff, supra*.) To establish transferee liability in equity, respondent must prove the following
8 elements: (1) the taxpayer-transferor transferred property to the transferee for less than full and
9 adequate consideration; (2) at the time of the transfer and at the time transferee liability is asserted, the
10 taxpayer-transferor was liable for the tax; (3) the transfer was made after the liability for the tax
11 accrued, whether or not the tax was actually assessed at the time of the transfer;⁵ (4) the taxpayer-
12 transferor was insolvent at the time of the transfer or the transfer left the taxpayer-transferor insolvent;
13 and (5) respondent has exhausted all reasonable remedies against the taxpayer-transferor. (*Appeal of*
14 *Zubkoff*.) The requirement that recovery be sought first against the taxpayer-transferor is waived where
15 it is apparent that proceeding against the transferor would be futile. For example, the taxing agency
16 may proceed directly against a transferee in the case of an insolvent transferor. (See, e.g.,
17 *Commissioner v. Kuckenber*g (9th Cir. 1962) 309 F.2d 202 [“the government need not take futile
18 assessment action against a taxpayer without assets”].)

19 *Beatrice Co. v. State Bd. of Equalization* (1993) 6 Cal.4th 767

20 In *Beatrice Co.*, a corporation created a subsidiary and transferred to it all the assets of
21 one of the corporation's divisions. The board of directors of the subsidiary issued 9,000 shares of the
22 subsidiary's stock to the parent corporation in exchange for the transfer of assets and the assumption by
23 the subsidiary of substantially all of the liabilities of the former division. In a hearing before this Board,
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25 ⁴ Transferee liability at law is generally found when transferees have expressly assumed the liabilities (i.e., pursuant to a
26 contract or other legal instrument). There is a no evidence here of any such express assumption, and therefore only the
27 equitable aspect of transferee liability shall be discussed herein.

28 ⁵ The *Appeal of Zubkoff* clarifies that a transferee is retroactively liable for the transferor's taxes in the year of the transfer
and in prior years to the extent of the assets received from the transferor, even though the transferor's tax liability might be
unknown at the time of the transfer, quoting *Leon Papineau v. Commissioner* (1957) 28 T.C. 54, 58.

1 the Board concluded that the transaction was a taxable retail sale and the corporation paid sales tax,
2 interest, and penalties. The corporation appealed and the California Supreme Court held that, under the
3 circumstances, the assumption by the subsidiary of the parent corporation's liabilities constituted
4 consideration for the transferred property which subjected the transaction to taxation under R&TC
5 sections 6051 and 6006. Although the parent remained primarily and jointly liable for the debts and
6 liabilities assumed by the subsidiary, the court held that the assumption agreement had value equal to
7 the cost to the corporation of paying its debts or fulfilling its obligations.

8 STAFF COMMENTS

9 With respect to the timeliness of the NPAs, the returns TYEs March 2004 through
10 March 2007 were filed on October 12, 2010, for TYEs March 2008 and March 2009 were filed on
11 March 15, 2011 and for TYE March 2010 was filed on October 5, 2011. Under R&TC section 19057,
12 subdivision (a), respondent was required to mail the NPAs within four years of those dates, i.e., on or
13 about October 12, 2014, March 15, 2015 and October 5, 2015, respectively. However, under R&TC
14 section 19074, subdivision (a), the limitation period for assessing transferee liability was extended for
15 one year after the period prescribed by R&TC section 19057, subdivision (a) and would expire on
16 October 12, 2015, March 15, 2016 and October 5, 2016, respectively. Thus, under those provisions, the
17 NPAs issued to appellant were timely. At the hearing, appellant should be prepared to present any other
18 legal authority to support his position that the NPAs were not timely issued.

19 With respect to the elements for establishing transferee liability in equity, the parties
20 should be prepared to address the following questions:

- 21 • Appellant states that he did not write checks to Main Credit because the revenues he "earned"
22 after "the closure of Fire X" went directly "from the customer to Main Credit." Appellant
23 should provide details to explain the operation of his business, the means by which he earned
24 those revenues and whether they were payable to Fire X for services he rendered on behalf of
25 the corporation or payable directly to him in his individual capacity. If the revenue was earned
26 by Fire X, the parties should discuss whether the fact that it was paid directly to Main Credit
27 constituted consideration for reasonably equivalent value from appellant to Fire X.
- 28 • If possible, appellant should provide additional evidence from 2009 and other years prior to

1 respondent's first contact with appellant regarding potential transferee liability to confirm that
2 the assumption agreement was entered into on or about March 31, 2009, and shed light on the
3 surrounding circumstances. Staff notes that, as the minutes and assumption agreement are
4 signed only by appellant, documents involving third parties might be helpful such as, perhaps,
5 correspondence from accountants or other financial advisors, financial institutions, or creditors
6 such as Main Credit indicating or acknowledging that appellant had assumed liability for
7 repayment.

- 8 • Appellant argues that Fire X was not rendered insolvent if the transfer occurred in either March
9 2009 or March 2010 because the agreement reduced Fire X's liabilities more than its asset
10 balance. Respondent notes that appellant fails to account for the tax liabilities that had accrued
11 at that time. At the hearing, appellant should be prepared to discuss whether after accounting for
12 accrued federal and state tax liabilities Fire X was insolvent after the transfer occurred.

13 Additional Evidence

14 If either party has additional evidence that the party wants the Board to consider, then
15 pursuant to California Code of Regulations, title 18, section 5523.6, that party should provide such
16 evidence to the Board Proceedings Division at least 14 days prior to the oral hearing.⁶
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28 ⁶ Exhibits should be sent to: Khaaliq A. Abd'Allah, Associate Governmental Program Analyst, Board Proceedings
Division, State Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.