

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 JAMES M. HEIM) Account Number: SR CH 53-002638
 6) Case ID 379939
 7 Petitioner) Tucson, Arizona

8 Type of Liability: Responsible person liability

9 Liability Period: 10/1/00 – 6/30/01

10 <u>Item</u>	<u>Amount</u>				
11 Responsible person liability	\$65,957				
		<u>Tax</u>	<u>Interest</u>	<u>Penalties</u>	<u>Total</u>
12 As determined	\$219,676.11	\$130,299.03	\$99,665.73	\$449,640.87	
13 Adjustment – Appeals Division	<u>-219,676.11</u>	<u>-103,291.88</u>	<u>-60,715.85</u>	<u>-383,683.84</u>	
14 Proposed redetermination, protested	<u>\$0.00</u>	<u>\$27,007.15</u>	<u>\$38,949.88</u>	<u>\$65,957.03</u>	

15 The Board hearing in this matter was held on September 1, 2009. The Board allowed petitioner
 16 30 days to provide additional evidence and the Sales and Use Tax Department (Department) 30 days to
 17 respond.

18 UNRESOLVED ISSUES

19 **Issue 1:** Whether petitioner is personally liable as a responsible person for the unpaid
 20 liabilities of Basis, Inc. (SR CH 21-741252) (Basis) for the period October 1, 2000, through April 30,
 21 2001 (4Q00 and 1Q01). We find that petitioner is personally liable for the 4Q00 and 1Q01.

22 Petitioner was a corporate officer of Basis, having acted as a director, chairman of the board,
 23 secretary, and treasurer. Petitioner was also a majority shareholder, CEO, and president of the parent
 24 corporation of Basis. On April 22, 2003, petitioner was forced to resign from his positions at Basis.
 25 Basis closed out its business on April 23, 2004, and forfeited its corporate status on September 15,
 26 2005. Basis' remaining liability at the close out date consisted of a late-payment penalty of \$11,447.18
 27 for 4Q00, a late-payment penalty of \$27,502.70 for 1Q01, unpaid interest of \$27,007.15, a self-
 28 assessed liability of \$219,676.11 tax for 2Q01, a late-payment penalty of \$25,211.80 for 2Q01, and an

amnesty interest penalty of \$35,504.05. The Department determined that petitioner is personally responsible pursuant to Revenue and Taxation Code section 6829 because he held various corporate officer positions at Basis, he was responsible for managing Basis' financial affairs, including the payment of tax to the Board, and he willfully failed to pay taxes due with respect to sales for which Basis collected sales tax reimbursement.

Petitioner asserts that two of the four conditions required for imposing liability under section 6829 are absent. Petitioner asserts that he was not the person responsible for sales and use tax matters during the liability period, and that instead those matters were handled locally, in California, by Ms. Viviana Magee, a former director of business services, and others to whom she reported.¹ Petitioner claims that he was only responsible for corporate finances at a much higher level, where his efforts were focused on securing capital and financing through private offerings and otherwise. He states that he did not become involved with sales and use tax matters for Basis until the board of directors requested that he deal with the company's tax issues in July 2001, at which time he came to California and met with the Board's compliance staff to negotiate an installment payment plan. Petitioner also contends that he never willfully failed to pay the liability. He claims that Basis' vendor and largest secured creditor, MRA Systems, Inc., dba GE Access (GE) to whom it owed \$5,688,355.71 (\$5 million principal and the remainder interest) as of December 29, 2000, controlled payments by Basis and he did all that he could do to continue to make the agreed-upon payments until he was forced out in April 2003. He also alleges that on February 24, 2004, when GE foreclosed on its security interest and took possession of all assets of Basis, those assets included more than \$500,000 in cash.

With respect to the issue of being personally responsible, petitioner held several corporate officer positions with Basis, the most relevant of which was as treasurer during the 2000-2001 and 2001- 2002 fiscal years. Some of the basic responsibilities of a corporate treasurer are financial

¹ In addition to petitioner, the Department considered issuing dual determination against Ms. Joyce Menke, Ms. Viviana Magee, Ms. Patricia Shanks, Mr. Donald Legnitto, and Mr. William Wallin. Due to insufficient evidence against Ms. Shanks, Mr. Legnitto and Mr. Wallin, their cases were not pursued. Consequently, dual determinations were issued against petitioner, Ms. Menke, and Ms. Magee. Ms. Menke did not file a petition for redetermination. Apparently, she resides in Iowa and the Department is trying to collect from her. Ms. Magee filed a petition for redetermination. The Department concluded that Ms. Magee could not act independently for the corporation in sales and use tax matters. Therefore, her petition was granted and her liability reduced to zero.

oversight and cash management. The fact that petitioner was the treasurer of Basis during the time that all of the liabilities at issue became due is sufficient prima facie evidence that he was responsible for the company's finances, including sales and use tax matters. Petitioner may have chosen to delegate those responsibilities to others, including Ms. Magee, but such a delegation did not relieve him of the ultimate responsibility for the finances of Basis, as is evident from the fact that petitioner was the executive who, in July 2001, came to California to personally handle the negotiations with the Board's compliance staff. By mid-July 2001, petitioner was personally and directly involved in handling sales and use tax matters for Basis. The Board's records indicate a first contact with petitioner on July 18, 2001, when he met in person with two of the compliance staff to negotiate a payment plan. The liability at issue here was discussed at the meetings between petitioner and Board staff on July 18 and 19, 2001, and petitioner negotiated an Installment Payment Agreement (IPA) covering the entire tax liability of Basis, including the liability for 2Q01, which was not due until July 31, 2001. Petitioner also remained involved in the process thereafter and renegotiated, or attempted to renegotiate, the IPA until shortly before his resignation on April 22, 2003. We find that this establishes that petitioner was a responsible person for Basis within the meaning of section 6829.

With respect to whether petitioner willfully failed to pay taxes due from the corporation, or cause them to be paid, a person is regarded as having willfully failed to pay taxes, or cause them to be paid, where he or she had knowledge that the taxes were not being paid (or lacked knowledge in reckless disregard of his or her duty to know) and had the authority to pay taxes or cause them to be paid, but failed to do so. Here, petitioner has not shown that GE had total control of the payments made by Basis, as more fully addressed under "Post Hearing Developments." Petitioner's handling of sales and use tax matters for Basis after mid-July 2001 clearly shows that he had the authority to direct payment of sales and use tax to the Board, and there is no evidence that he did not have that same authority during all relevant times. Bank records show ending balances for August 31, September 30, and October 31, 2002, of \$200,827.27, \$26,453.90, and \$128,228.24, respectively. This evidence is sufficient to show that Basis had funds available to pay the liability. It chose not to pay them. Based on these facts, we find that the evidence is sufficient to show that petitioner willfully failed to pay the

taxes for 4Q00 and 1Q01 when they became due. Accordingly, we conclude that petitioner is personally responsible for the liabilities of Basis for 4Q00 and 1Q01.

Issue 2: Whether petitioner has established reasonable cause to relieve the late-payment penalties assessed against Basis that were passed through to him as a responsible person. We conclude that petitioner has failed to establish reasonable cause to relieve the penalties for the periods of 4Q00 and 1Q01.

There is no statutory or regulatory authority for relieving late-payment penalties in section 6829 determinations, but the penalties can be relieved as to Basis if a request for relief of such penalties filed on behalf of Basis establishes that relief should be granted. To the extent that relief of penalties were granted to Basis, such relief would inure to petitioner's benefit as well. Petitioner requested relief of this penalty on behalf of Basis, reiterating that GE controlled the funds required to pay the liabilities and stating that he lacks personal knowledge of specific events during the periods in issue. We conclude that petitioner's declaration does not establish good cause to relieve the late-payment penalties for 4Q00 and 1Q01 and we are not aware of any circumstances that would warrant granting such relief to Basis. We recommend that relief be denied.

RESOLVED ISSUE

We recommend that the liability for 2Q01 be deleted from petitioner's responsible person liability. We find that petitioner did not willfully fail to pay or cause to be paid Basis' 2Q01 liabilities because the Department acquiesced in Basis' failure to pay the full amount when due by entering into a payment plan with Basis (after the due dates for 4Q00 and 1Q01, but before the due date for 2Q01), and the evidence shows that petitioner acted in good faith to comply with that agreement until it was no longer within his power to do so. It was not until after petitioner resigned and no longer had any control over the finances of Basis that the default became incurable. We find that under these exceptional circumstances, petitioner did not willfully fail to pay the liability of Basis for 2Q01.

POST HEARING DEVELOPMENTS

During the Board hearing, petitioner contended that additional adjustments are warranted for bad debts. This contention had not been raised at the appeals conference and was not addressed in the D&R. The Board allowed petitioner additional time to produce documentation to support any

additional adjustments for bad debts, as well as in support of petitioner's contention that GE Access had total control over the payments made by Basis. Petitioner did not provide any additional documentation in support of his contention that GE Access controlled all payments made by Basis. The bankruptcy court motion provided by petitioner alleges that GE Access had filed financing statements with respect to Basis and had a security interest in certain proceeds pursuant to an assignment agreement with Basis dated April 9, 2001. Although petitioner did not provide copies of these financing statements and the agreement, the Department obtained copies, the only one of which that appears even arguably relevant to petitioner's contentions for the periods at issue being the assignment agreement.

The assignment agreement, entered into on or about April 9, 2001, related to proceeds payable to Basis in connection with its sales of goods obtained from GE Access with credit from GE Access pursuant to the assignment agreement. That is, even if the agreement gave GE Access the full control over the applicable proceeds that petitioner alleges, the agreement did not apply to proceeds from sales made before April 9, 2001. Thus, the agreement is wholly irrelevant to the liability of Basis for 4Q00, which was due January 31, 2001. Furthermore, it is virtually certain that the agreement is similarly irrelevant as to the liability for 1Q01, which had been fully accrued by March 31, 2001 (before the agreement) and was due on April 30, 2001. That is, for the agreement to have had any effect on the ability of Basis to pay the tax due for 1Q01, such impairment could have related only to proceeds for sales made by Basis during about 20 days, between the date of the agreement and due date of the tax. However, the proceeds from sales made during that period would not have been covered by the agreement if the merchandise sold had been obtained by Basis prior to April 9, 2009. In short, petitioner has not shown that the assignment agreement in any way impacted the ability of Basis to pay the amounts the 1Q01 liability on its April 30, 2001 due date. We conclude that petitioner's post-hearing submission does not overcome our finding that the requirements for imposing liability on petitioner pursuant to Revenue and Taxation Code section 6829 for the tax debts incurred by Basis during 4Q00 and 1Q01 have been satisfied.

With respect to petitioner's arguments that bad debt deductions are allowable, our understanding is that what petitioner actually seeks is an offset against his liability for a refund he

asserts was incorrectly denied in connection with the final return filed by Basis for 4Q03, due on January 31, 2004. The threshold issue is, of course, whether bad debt deductions were allowable for 4Q03. In order to show that such was the case, petitioner had to establish that Basis had reported the applicable transactions as taxable and thereafter properly charged off the debts. The documentation petitioner submitted on this issue indicates that various accounts were reflected as being “reserved in bad debt” on a Consolidated Accounts Receivable at January 31, 2004. This does not, of course, establish that the transactions were reported as taxable or were properly written off. We find that petitioner has not established that Basis was entitled to any refund for having failed to take allowable bad debt deductions. (Cal. Code Regs., tit. 18, § 1642, subd. (e).) Furthermore, even if petitioner had shown that a refund should have been granted for 4Q03 with respect to allowable bad debt deductions, that does not mean such an adjustment would inure to petitioner’s benefit.

Petitioner now claims that a refund of \$28,584 should have been granted. However, petitioner is not being held responsible for all of the debt owed by Basis. Rather, as noted above, we recommend that the liability for 2Q01 be eliminated, which removes all tax, and substantial portions of the interest and penalties. In total, we recommend a reduction *to petitioner’s liability* from \$449,640.87 to \$65,957.03. Basis, however, remains liable for the entire \$449,640.87, plus additional accrued interest, and as particularly relevant, all of the tax. Payments and credits are generally applied to tax first. Thus, even if it were determined that Basis were entitled to a offset of almost \$30,000 for allowable bad debt deductions not previously allowed, that offset would generally be applied to the tax owed by Basis, meaning that petitioner’s liability would not be impacted by granting the claimed offset. In any event, we need not reach a final conclusion on the issue of the proper application of a refund as an offset against the debt owed by Basis since we find that no overpayment has been shown.

Finally, we note that, although petitioner characterizes the alleged overpayment as tax related to bad debts, he has included a declaration from Mr. Vincent Kmett, who says he was general manager of Basis from March 1, 2001 until May 1, 2004. Mr. Kmett’s declaration concerns sales to three persons. For sales to Priocom Corp, Mr. Kmett states his recollection that these orders were shipped and invoiced in December 2003 to the purchaser’s Portland, Oregon office and should not have been billed as taxable. This statement is inadequate to support a claim that the sales were required to be

shipped to the purchaser outside California, and that the product was in fact so shipped. Thus, we find that petitioner has failed to show that Basis overpaid any tax for 4Q03 related to these sales. For sales to Health Comp., Mr. Kmett states the purchaser was part of a state agency and exempt from taxation. There is no such exemption from California sales tax, so this statement does not support that there was any overpayment of tax. Finally, for sales to Sun Valley Tech., Mr. Kmett states that the company was a reseller who claimed it was “non-taxable.” In the absence of a resale certificate or any other documentation whatsoever, there is no basis to find that Basis overpaid tax with respect to sales to Sun Valley Tech. As noted above, had Mr. Kmett’s statement supported a finding that Basis overpaid tax, it does not appear that petitioner would benefit since any offset would generally be applied to the tax owed by Basis, for which petitioner is no longer being held dually liable. Again, we need not resolve that issue since we find that petitioner has not established any overpayment of tax.

We recommend that the liability for 2Q01 be removed from the deficiency and that the matter otherwise be redetermined without adjustment.

Summary prepared by David H. Levine, Tax Counsel IV