STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	Account Number: SR AP 53-001918 Case ID 316054
ELIZABETH WARDLEY KWONG	)	Account Number: SR AP 53-001917 Case ID 316055
RAYMOND WAH KWONG	)	
Petitioners	))	Altadena, Los Angeles County

Type of Liability: Responsible Person Liability

Liability Period: 1/1/00 – 3/28/01

Item	Amount in Dispute
Responsible person liability	$101,371
Bad debt deduction	$ 84,708

	Tax	Penalties
As determined	$99,166.00	$35,621.96
Adjustment - Sales and Use Tax Department	- 10,011.00	- 3,766.62
- Appeals Division	00.00	- 19,639.84
Proposed redetermination, protested	$89,155.00	$12,215.50

Proposed tax redetermination	$89,155.00
Interest to 8/31/10	83,064.32
Penalties	12,215.50
Total tax, interest, and penalties	$184,434.82
Monthly interest beginning 9/1/10	$520.07

At the appeals conference, petitioners stated they no longer contest their liability as responsible persons for the liability of The Permanent Wiseguys, Inc. (Wiseguys) (SR AP 17-806560), and thus, in our Decision and Recommendation (D&R), we recommended that the matter be redetermined without adjustment. After we issued our D&R, petitioners filed a settlement proposal, but the settlement negotiations were not successful. Petitioners thereafter requested a Board hearing, and that hearing was scheduled for October 2, 2007. However, since our D&R did not identify any remaining disputes, the original hearing date was postponed so that we could contact petitioners to determine the issues that remained for decision by the Board. After petitioners identified those remaining issues, we issued a Supplemental D&R to address them.

The Board held the oral hearing in this matter on February 24, 2010, granting petitioners 30 days to provide additional records supporting alleged bad debts and the Sales and Use Tax Department (Department) 30 days to respond. The discussion of bad debts under Issue 2, below, is as of the Board hearing, and the post-hearing submissions are discussed under Post Board Hearing Developments.

UNRESOLVED ISSUES

Issue 1: Whether petitioners' liability as responsible persons has been discharged as a result of the bankruptcy of Wiseguys or as a result of petitioners' personal bankruptcy. We conclude that the liabilities have not been discharged.

There is no dispute that petitioners are personally liable under Revenue and Taxation Code section 6829 for the portion of the unpaid liabilities of Wiseguys that the Department continues to assert they owe (see discussion under "Resolved Issues"). Wiseguys filed for Chapter 11 bankruptcy on September 15, 2000 (Case No. LA 00-36186-VZ). On April 2, 2001, the case was converted to a Chapter 7 bankruptcy, and it was closed on September 22, 2004. Petitioners filed for Chapter 7 bankruptcy on March 22, 2002 (Case No. LA 02-18641-VZ) and were granted a discharge on September 9, 2002.

Taxes are generally not dischargeable in bankruptcy. (11 U.S.C. §§ 523(a)(1)(A), 507(a)(8).) Section 523(a)(1)(A) of title 11 of the U.S. Code provides that taxes "of the kind and for the periods" specified in section 507(a)(8) of the U.S. Bankruptcy Code are non-dischargeable in bankruptcy. (See also 11 U.S.C. § 727(b).) A bankruptcy court discharge does not discharge taxes measured by gross receipts, such as the sales tax at issue here, that are not assessed before the bankruptcy petition is filed but remain assessable thereafter. (11 U.S.C. § 523(a)(1)(A), 507(a)(8)(A) (iii), see also *George v. California State Bd. of Equalization* (9th Cir. BAP 1989) 95 B.R. 718, 721 (holding that responsible person liability is a tax for determining dischargeability in bankruptcy).)

Petitioners assert that the Board was listed as a creditor in these bankruptcy cases but did not file any claims. Ms. Kwong also asserts, "Our bankruptcy attorney and Trustee advised us that both cases have been released, the court approved the Trustees [sic] request for final payment to creditors and these have all been made. We met all the requirements of our bankruptcies and we are no longer under any monetary obligation."

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The Department states that, contrary to petitioners' assertion, it filed a claim in the bankruptcy of Wiseguys on July 25, 2001, which was prior to the claims deadline of August 21, 2001.[1] The Department states that the Board did not receive any payment on its claim in the bankruptcy of Wiseguys. As for petitioners, the Department notes that it issued the Notices of Determination to petitioners for responsible person liability on June 9, 2005, more than two years after they filed for bankruptcy. Therefore, the Department contends that the liabilities were not discharged in bankruptcy because the liabilities of petitioners as responsible persons were assessed after their bankruptcy case closed, and therefore their personal liabilities were not discharged in bankruptcy.

Petitioners filed their personal petition for bankruptcy in 2002, and the Department did not issue the Notices of Determination to petitioners at issue here until over three years later in 2005. Since those determinations were timely, the determined liabilities remained assessable after the filing of the personal bankruptcy. (In fact, a tax is assessed for purposes of bankruptcy law when the determination becomes final, so the disputed liability has still not been "assessed" for bankruptcy purposes, but remains assessable.) Thus, the personal liability of petitioners for Wiseguys' unpaid liabilities to the Board was not discharged in their bankruptcy proceeding.

Issue 2: Whether petitioners have established that any adjustments are warranted to the underlying liability of Wiseguys due to bad debts. We recommend no adjustments.

Petitioners submitted two charts that purportedly show the bad debts deduction that Wiseguys was entitled to claim, and based on our conversation with Mrs. Kwong and review of the charts, we ascertained that petitioners seek a bad debt allowance of $84,708.15. However, petitioners provided insufficient documentation to establish the elements required to qualify for a bad debt deduction: (1) the date of the original sale; (2) the name and address of the purchaser; (3) the amount the purchaser contracted to pay; (4) the amount on which Wiseguys paid tax; (5) the jurisdiction(s) where the local taxes and, as applicable, district taxes were allocated; (6) all payments or other credits applied to the purchaser's account; (7) evidence that the uncollectible portion of the gross receipts on which tax was

[1] The Department also states that corporations are not eligible to receive a discharge in a Chapter 7 proceeding pursuant to 11 U.S.C. section 727 (a).)

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paid actually has been legally charged off as a bad debt for income tax purposes in accordance with generally accepted accounting principles; and (8) the taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which Wiseguys reported and paid tax. (Cal. Code Regs., tit. 18, 1642, subd. (e).) Accordingly, absent such documentation, we concluded that petitioners failed to establish that any adjustment to the underlying liability of Wiseguys is warranted for bad debts.

AMNESTY

An amnesty interest penalty was imposed on Wiseguys because of its failure to participate in the amnesty program, and that penalty was included in each of the determinations issued to petitioners. We had not explained to petitioners that they could request relief of that penalty on Wiseguys' behalf, nor had we considered whether relief would be warranted. After this omission was brought to our attention, we considered the circumstances and have concluded that relief of the amnesty penalty would be warranted, if a proper request were submitted, because Wiseguys had a reasonable basis for not participating in the amnesty program (that is, Wiseguys was closed out, with its remaining assets distributed, well before the amnesty program).

Petitioners have now submitted a request for relief of the amnesty interest penalty, signed under penalty of perjury. We therefore recommend that the amnesty interest penalty of $19,639.84 be relieved if petitioners paid the tax and interest they owe within 30 days of the Notice of Redetermination or if, within 30 days of the Notice of Redetermination, petitioners enter into an installment payment plan to pay that tax and interest within 13 months and successfully complete that agreement.

RESOLVED ISSUE

As we advised the Board prior to the hearing, upon further review of the facts in this case, the Department concluded that petitioners did not willfully fail to pay the tax due for the first quarter 2001. The return for that period was due on April 30, 2001, at which time Wiseguys was in bankruptcy. The Department concluded that on the due date of the tax for the first quarter 2001, the bankruptcy trustee had total control over the assets of Wiseguys and petitioners did not willfully fail to pay the tax due for that quarter. Accordingly, the Department recommends that the amounts owed by Wiseguys for the first quarter 2001 (tax of $10,011, penalties of $3,766.62, and applicable interest) be removed from the

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liability owed by petitioners, and we agree.

POST HEARING DEVELOPMENTS

Petitioners claimed that Wiseguys' records were surrendered to the Bankruptcy Trustee during the bankruptcy proceeding, and thus petitioners cannot provide records to support their claim. The Board directed the Department to contact the Bankruptcy Trustee and Wiseguys' Bankruptcy attorney to try to obtain Wiseguys' accounting records. The Department attempted to obtain the records as directed by the Board, but both the Trustee and the attorney claim they do not have the records. Thus, the only basis for allowing any bad debts would be if petitioners could themselves provide the necessary supporting documentation.

Along with correspondence dated March 30, 2010, petitioners submitted a spreadsheet showing the alleged bad debts that petitioners assert Wiseguys was entitled to claim for the period January 2000 through June 2000. This spreadsheet is essentially the same information petitioners had provided to the Appeals Division when we were preparing the SD&R in this appeal (though the totals on the spreadsheet petitioners provided after the hearing are correct, while the totals on the submission to us prior to our issuance of the SD&R were not). However, as before, no supporting documents were provided with the spreadsheet or otherwise. There are no records to show that bad debts were claimed for income tax purposes by Wiseguys, nor are there any records to show that Wiseguys reported and paid tax to the Board on the sales listed on the spreadsheet. By memorandum dated April 12, 2010, the Department explains its conclusion that, even though the spreadsheet listed several prominent customers, petitioners have not provided sufficient evidence support the alleged bad debts, and are therefore not entitled to bad debt allowance.

Absent any supporting documentation to show that bad debt deductions were warranted, we conclude that petitioners have failed to establish that a bad debt allowance is warranted. Thus, we continue to recommend that the responsible person liabilities be redetermined with no adjustment other than those described under "Resolved Issues" and, subject to the payment condition noted above, relief of the amnesty interest penalty.

Summary prepared by Rey Obligacion, Retired Annuitant

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