BOARD OF EQUALIZATION

BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE JOHN CHIANG, COMMITTEE CHAIR
450 N STREET, SACRAMENTO
MEETING DATE: MAY 2, 2000, TIME: 1:30 PM

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

Title: Proposed Regulatory Changes to Clarify Responsible Person Liability in the Case of Dissolved or Suspended Corporations (Regulation 1702.6)

Issue/Topic:

Should proposed Regulation 1702.6, *Suspended Corporations*, be adopted to clarify corporate officer and shareholder personal liability, under certain conditions, in the event the corporation is suspended?

Committee Discussion:

Action 1 – Consent Items

There was no discussion of this action item.

Committee Action/Recommendation/Direction:

Action 2 – Authorization to Publish

The Committee directed staff to request authority to publish new Regulation 1702.6, *Suspended Corporations*. There is no operative date, and implementation will take place upon approval by the Office of Administrative Law. A copy of the proposed regulation is attached.

Agenda Item No: 2

Title: Proposed Revisions to Audit Manual Chapter 10 (Occasional Sales – Sale of a Business)

Issue/Topic:

Should revisions to Chapter 10 be incorporated into the Board of Equalization Audit Manual?

Committee Discussion:

Action 1 – Consent Items

Staff provided copies of revised language for section 1004.10, submitted for consideration by Mr. Frederick Richman of O'Melveny & Myers on April 28, 2000, and subsequently agreed to by staff and interested parties.

Action 2 – Definition of the Types of Sales That Qualify a Seller as Making More Than Two Sales in a 12-Month Period

Staff stated that the interested party, Mr. Eric Miethke, representing the Motion Picture Association of America, has withdrawn his proposal. Mr. Miethke then addressed the Committee, confirming his agreement in concept with staff's recommendation. However, he noted the need for some minor wording changes, and a Committee Member also suggested a punctuation revision.

Action 3 – Determination of Whether All Sales Qualifying as Taxable in Each 12-Month Period Are Subject to Tax

Staff stated its position that under Revenue and Taxation section 6051, gross receipts are subject to tax if the seller is a retailer, unless otherwise supported as exempt, and noted that Regulation 1595 is explicit on this issue.

Mr. Miethke stated his position that only the third, and any subsequent, sale in a 12-month period is subject to tax. Excess tax reimbursement would result if the seller did not make the third sale but collected the tax on the previous two sales. Conversely, if the seller did not know at the time that they made the first two sales that they would be making a third sale, they would not collect tax on the first two sales. When the third sale is made, tax would be due on all three sales, even though the seller would not have collected tax on the first two sales. This results in an untenable position for the seller.

The Committee agreed that this was an untenable position for the seller but they also agreed with staff that the Audit Manual chapter was not the appropriate place for this discussion.

Action 4 – Authorization to Publish

There was no discussion of Action Item 4.

Committee Action/Recommendation/Direction:

Action 1 – Consent Items

The Committee authorized staff to incorporate consent item revisions into Chapter 10 of the Audit Manual.

Action 2 – Definition of the Types of Sales That Qualify a Seller as Making More Than Two Sales in a 12-Month Period

The Committee approved staff's recommendation to adopt proposed revisions as agreed upon by staff and interested parties. The Committee also approved staff's request to work with Mr. Miethke to refine the language of section 1001.30. A copy of the final revised language, agreed upon by staff and Mr. Miethke, is attached.

Action 3 – Determination of Whether All Sales Qualifying as Taxable in Each 12-Month Period Are Subject to Tax

The Committee took no action. The Committee recommended that Mr. Miethke's concerns be addressed through the regulatory revision process. The Committee Chairman stated that he would have his staff work with Department staff to expedite placement of this issue on the Business Taxes Committee calendar.

Action 4 – Authorization to Publish

The Committee authorized staff to publish the revisions to Audit Manual Chapter 10.

Agenda Item No: 3

Title: Proposed Regulations to Clarify the Application of the Emergency Telephone Users Surcharge Law (Regulations 2401, 2403, and 2432)

Issue/Topic:

Should the Board adopt regulations to clarify the application of the Emergency Telephone Users Surcharge (the "911 Surcharge") on dollar amounts or value of minutes deducted upon use from prepaid telephone calling cards?

Committee Discussion:

Action 1 – Consent Items

Staff and industry agreed on the proposed language of the amendments to Regulation and adoption of Regulation 2432. There was no discussion of these items.

Action 2 – Regulation 2403 Prepaid Telephone Calling Cards

Five members of industry discussed their specific difficulties in complying with the regulation.

Action 3 – Authorization to Publish

There was no discussion of this item.

Committee Action/Recommendation/Direction:

Action 1 – Consent Items

The committee approved all consent items.

Action 2 – Regulation 2403 Prepaid Telephone Calling Cards

The committed approved the regulation.

Action 3 – Authorization to Publish

The committee directed staff to request authority to publish the attached revised Emergency Telephone Users Surcharge Regulation 2401, *Definitions*, and the adoption of Regulations 2403, *Prepaid Telephone Calling Cards* and 2432, *Relief from Liability*.

Approved: /s/ John Chiang
Honorable John Chiang, Committee Chair

/s/ James E. Speed
James E. Speed, Executive Director

BOARD APPROVED

at the May 4, 2000 Board Meeting

/s/ Judy Newton
Judy Newton, Chief
Board Proceedings Division

Regulation 1702.6. SUSPENDED CORPORATIONS.

(a) GENERAL. A corporate officer or shareholder with control over operations or management of a closely held corporation during a time in which the corporation's powers, rights, and privileges are suspended or any responsible person who fails to pay or to cause to be paid any taxes due from a closely held corporation during a time in which the corporation's powers, rights, and privileges are suspended shall be personally liable under the circumstances set forth below for any unpaid sales or use tax liability of that suspended corporation incurred during the period of that suspension. The corporate officer, shareholder, or responsible person shall be liable for the unpaid tax, and interest and penalties on those taxes not so paid, regardless of the basis for the suspension of the corporation's powers, rights, and privileges.

Personal liability under this regulation applies only when the Board establishes that, during the period of suspension, the corporation:

(1) Sold tangible personal property in the conduct of its business and collected sales tax reimbursement on the selling price (whether separately itemized or included in the selling price) and failed to remit such tax when due; or

(2) Collected use tax and failed to report and pay the tax; or

(3) Consumed tangible personal property and failed to pay the applicable tax to the seller or the Board.

(b) DEFINITION OF TERMS.

(1) RESPONSIBLE PERSON. For the purposes of this regulation, the term "responsible person" means any officer or shareholder who is charged with the responsibility for the filing of returns or the payment of tax or who has a duty to act for the closely held corporation in complying with any provision of the Sales and Use Tax Law, and who derives a direct financial benefit from the failure to pay the tax liability.

(2) CLOSELY HELD. For the purposes of this regulation, the term "closely held" corporation means one in which ownership is concentrated in one individual, one family, or a small number of individuals and the majority stockholders manage the business.

(3) CONTROL OVER OPERATIONS OR MANAGEMENT. For the purposes of this regulation, the term "control over operations and management" means the power to manage or affect day to day operations of the business. For the purposes of this regulation, it is rebuttably presumed that a corporate officer has control over operations and management of the closely held corporation.

(c) DETERMINATION AND COLLECTION. The Board shall determine and collect the liability established under this regulation in the manner provided in Chapter 5 (commencing

with section 6451) and Chapter 6 (commencing with section 6701) of Part 1, Division 2, of the Revenue and Taxation Code.

(d) LIABILITY OF THE CORPORATION. A suspended corporation shall remain liable for the unpaid tax, interest, and penalties incurred during the period in which its corporate powers, rights, and privileges were suspended without regard to any personal liability determined under subdivision (a) of this regulation. Payments made pursuant to subdivision (a) shall be applied to the liability of the corporation.

NOTE: Authority: Section 7051, Revenue and Taxation Code.
Reference: Section 6066, Revenue and Taxation Code.

Business Taxes Committee – May 2, 2000

Item 2 – Proposed Revisions to Audit Manual Chapter 10

Action 2 – Definition of Types of Sales That Qualify a Seller as Making More Than Two Sales in a 12-Month Period:

Revised as Directed by the Business Taxes Committee

DETERMINATION OF NUMBER OF SALES 1001.30

More than two sales of tangible personal property for substantial amounts during any 12-month period (not calendar year) requires the holding of a seller's permit. **Sales of tangible personal property are only included in determining whether a person has made more than two sales during a 12-month period if the tangible personal property is of a kind the gross receipts from the retail sale of which are taxable, whether or not ever sold at retail *by that person*. Transactions excluded from the definition of "sale" by the Revenue and Taxation Code are not considered when determining whether the holding of a seller's permit is required.** In determining whether a person has made ~~three or~~ more than two sales during a 12-month period, the following types of sales are ~~to be~~ excluded:

a) Trade-ins made incidental to a nonselling activity. For example, an accountant trading in an old copier for a new one.

b) Sales made by an auctioneer on behalf of the person ~~subject~~(auctioneer is the retailer and liable for the tax).

c) Sales of horses through claiming races (racing association is the retailer ~~seller~~ and liable for the tax).

d) Sales of vehicles, vessels or aircraft, ~~the sale of which is~~ exempt~~ed~~ from the sales tax by Law Sections 6282 and 6283, but subject to use tax imposed on the purchaser.

Persons ~~Anyone~~ engaged in a business which does not require the holding of a seller's permit ~~is~~ are not liable for sales tax measured by the gross receipts from a retail sale of a piece of equipment used in the conduct of the business, even though he or she may have made a series of trade-ins of old for new equipment ~~for new, incidental to the business~~. The sale of the equipment in question is not regarded as one of a series of sales, or the equipment as having been used in a selling activity and thus, the sale is an occasional sale.

If, however, in addition to the sale in question, two or more sales of substantial amounts have been made or are made in a period of 12 months, ~~the sale is taxable~~ regardless of whether ~~even though~~ the other sales were at retail, ~~sales~~ for resale, or exempt from tax (for example, a sale in interstate commerce), all of the non exempt sales at retail are subject to tax.

In determining whether the sales are for "substantial" amounts, the auditor should consider all the facts of each situation. The Board has considered the issue of what constitutes sales in substantial amounts in the Memorandum Opinion of Pratt North Plaza Associates (10/28/93). The Board concluded that a sale of $400 is a substantial amount for the purposes of Regulation 1595, and the Board specifically did not address the issue whether sales in amounts less than $400 are substantial. Until otherwise directed, any sale of $400 or more clearly counts as a sale for a substantial amount, and sales less than $400 may also be considered substantial. Auditors should consult with their supervisor if any questions arise in determining whether a sale of tangible personal property is a sale for a "substantial" amount.

Regulation 2401. Definitions

(a) Service Supplier. "Service Supplier" means any person supplying intrastate telephone communication services to any service user in this state, provided however:

(1) Where intrastate telephone communication services are supplied through a prepaid telephone calling card, the "service supplier" means the person that provides access to its lines and switches for telephone services and is responsible for deducting the amounts charged for telephone services used from amounts of service available on the prepaid telephone calling card.

(2) A wholesaler or retailer of prepaid telephone calling cards is not a service supplier unless it provides access to its lines and switches for telephone services and is responsible for deducting the amounts charged for telephone services used from amounts of service available on the prepaid telephone calling card.

(b) **Intrastate Telephone Communication Services.** "Intrastate telephone communication services" means all local or toll telephone services where the point or points of origin and the point or points of destination of the services are all located in this state. It includes the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radiotelephone stations constituting a part of a
local telephone system and any facility or service provided in connection with local telephone service. It also includes telephonic quality communication for which there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication as well as a service which entitles the subscriber, upon payment of a periodic charge (whether a flat charge or a charge based upon total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radiotelephone stations in a specified area which is outside the local telephone system area in which the station provided with the service is located.

(c) Billing Agent. "Billing Agent" shall mean any person that submits a bill to a service user on behalf of another person who is a service supplier, reseller or billing aggregator. A billing agent is not considered to be a service supplier for intrastate telephone communication services provided by or billed on behalf of that person.

(**d) Billing Aggregator.** "Billing Aggregator" shall mean any person engaged in the business of facilitating the billing and collection of charges for intrastate telephone communication services by aggregating the information about telephone communication services provided by one or more service suppliers and submitting the combined information to one or more local exchange carriers for billing and collection. The billing aggregator may contract with service suppliers to:

(1) receive call information detail from one or more service suppliers and submit that call information detail to one or more local exchange carriers acting as billing agents;
(2) receive payments from local exchange carriers acting as billing agents for disbursement as directed by service suppliers; and

(3) prepare and file returns and remit the surcharge to the Board in the manner provided in the applicable contract.

A billing aggregator shall identify all service suppliers on whose behalf it will prepare and file returns at such time and in such form as the Board requests.

(e) Prepaid Telephone Calling Card. "Prepaid telephone calling card" means any card, or other identifier such as an authorization number or access code, which is purchased in advance of use of telephone services, and entitles the holder of the card or user of the authorization number or access code to a specified dollar amount or number of minutes of telephone service, where dollar amounts or minutes for telephone services used are deducted from the amount of prepaid service available on the prepaid telephone calling card as local and long distance telephone services are provided to the user of the prepaid telephone calling card.

Regulation 2403. Prepaid Telephone Calling Cards

(a) The surcharge applies to the dollar amounts deducted or the value of the minutes deducted from the prepaid telephone calling card by the providing service supplier to the extent that those dollar amounts or minutes were deducted to pay for intrastate telephone communication services provided to the user of the prepaid telephone calling card. Dollar amounts or minutes deducted for interstate telephone communication services are exempt from the surcharge. Dollar amounts or minutes of telephone service which are forfeited because they have not been used prior to the expiration of the prepaid telephone calling card are not subject to the surcharge.

(b) Where intrastate telephone communication services are supplied through a prepaid telephone calling card, the providing service supplier may apply the surcharge to an estimate of the charges for intrastate services subject to the surcharge. The estimate of charges may be based on such call information as the providing service supplier reasonably believes demonstrates the approximate amount of intrastate telephone communication service charges subject to the surcharge.

(c) If a prepaid telephone calling card contains a statement that the price of the card includes applicable taxes and fees, the service supplier responsible for collecting and paying the surcharge on intrastate telephone communications services provided pursuant to the card may reduce the taxable measure of such services by taxes and fees which are not subject to the 911 surcharge. Taxes and fees which are not subject to the 911 surcharge include the federal excise tax and the 911 surcharge. Taxes and fees imposed on the service supplier by statute, such as those imposed by the California Public Utilities Commission, may not be deducted from the taxable measure.

Regulation 2432. Relief from Liability

(a) In General. A person may be relieved from the liability for the payment of the Emergency Telephone Users Surcharge, including any penalties and interest added to the surcharge, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) Written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) Written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below; or

(3) Written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person.

The term "written advice" includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term "written advice" includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided In a Prior Communication. Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(c) Written Advice Provided In a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the

person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) The underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) The annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body or a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations. A trade or industry association seeking advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.