



STATE BOARD OF EQUALIZATION

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State Controller

CYNTHIA BRIDGES
Executive Director

March 18, 2016

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for proposed amendments to Regulation 1702.5, *Responsible Person Liability*, which will be presented at the Board's March 30, 2016 Business Taxes Committee meeting. The proposed amendments clarify definitions, explain the applicable standard of proof, and add a rebuttable presumption of when there is no personal liability for certain types of persons.

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:00 a.m.** on **March 30, 2016** in Room 121 at the address shown above.

Sincerely,

A handwritten signature in cursive script that reads "Susanne Buehler".

Susanne Buehler, Chief
Tax Policy Division
Business Tax and Fee Department

SB:lw

Enclosures

cc: (all with enclosures, via email and/or hardcopy as requested)
Honorable Fiona Ma, CPA, Chairwoman
Honorable Diane L. Harkey, Vice Chair
Honorable George Runner, Member, First District
Honorable Jerome E. Horton, Member, Third District
Honorable Betty T. Yee, State Controller, c/o Ms. Yvette Stowers (MIC 73)

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Ms. Kathryn Asprey, Board Member's Office, Second District
Mr. John Vigna, Board Member's Office, Second District
Mr. Tim Morland, Board Member's Office, Second District
Mr. Russell Lowery, Board Member's Office, Fourth District
Mr. Ted Matthies, Board Member's Office, Fourth District
Ms. Lisa Renati, Board Member's Office, Fourth District
Mr. Clifford Oakes, Board Member's Office, Fourth District
Mr. Sean Wallentine, Board Member's Office, First District
Mr. Lee Williams, Board Member's Office, First District
Mr. Brian Wiggins, Board Member's Office, First District
Mr. Cary Huxsoll, Board Member's Office, First District
Mr. Alfred Buck, Board Member's Office, First District
Ms. Kari Hammond, Board Member's Office, Third District
Ms. Shellie Hughes, Board Member's Office, Third District
Mr. Ramon Salazar, State Controller's Office (MIC 73)
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris (MIC 83)
Mr. David Gau (MIC 101)
Ms. Lynn Bartolo (MIC 43)
Mr. Todd Gilman (MIC 70)
Mr. Wayne Mashihara (MIC 47)
Mr. Kevin Hanks (MIC 49)
Mr. Mark Durham (MIC 67)
Mr. Robert Tucker (MIC 82)
Mr. Jeff Vest (MIC 85)
Mr. Jeff Angeja (MIC 85)
Mr. David Levine (MIC 85)
Ms. Dana Brown (MIC 85)
Ms. Casey Tichy (MIC 85)
Ms. Linda Cheng (MIC 85)
Ms. Nikki Mozdyniewicz (MIC 85)
Mr. Rick Zellmer (MIC 85)
Mr. Bradley Heller (MIC 82)
Mr. Lawrence Mendel (MIC 82)
Mr. John Thiella (MIC 73)
Ms. Christine Bisauta (MIC 82)
Ms. Kirsten Stark (MIC 50)
Mr. Marc Alviso (MIC 101)
Mr. Chris Lee (MIC 101)
Ms. Lauren Simpson (MIC 70)
Ms. Karina Magana (MIC 47)
Mr. Bradley Miller (MIC 92)
Mr. Bill Benson (MIC 67)
Mr. Robert Wilke (MIC 50)
Ms. Lynn Whitaker (MIC 50)

Agenda – March 30, 2016 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1702.5, *Responsible Person Liability*

<p>Action 1 – Agreed Upon Items</p> <p>Agenda, pages 2-5.</p>	<p>Alternative 1</p> <p>Approve and authorize publication of proposed amendments to Regulation 1702.5, <i>Responsible Person Liability</i>, to clarify definitions, explain the applicable standard of proof, and add a rebuttable presumption of when there is no personal liability for certain types of persons.</p> <p style="text-align: center;">OR</p> <p>Alternative 2</p> <p>Do not approve proposed amendments to Regulation 1702.5.</p>
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Agenda – March 30, 2016 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1702.5, *Responsible Person Liability*

Action Item	Staff and Industry's Proposed Regulatory Language
<p>Action 1 – Staff Recommendation</p>	<p>REGULATION 1702.5. RESPONSIBLE PERSON LIABILITY.</p> <p>(a) GENERAL. Any responsible person who willfully fails to pay or to cause to be paid, under circumstances set forth below, any taxes due from a corporation, partnership, limited partnership, limited liability partnership, or limited liability company pursuant to Part 1, Division 2, of the Revenue and Taxation Code shall be personally liable for any unpaid taxes and interest and penalties on those taxes not so paid upon termination, dissolution, or abandonment of the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company.</p> <p>Personal liability shall <u>only</u> apply if the Board establishes that while the person was a responsible person, <u>as defined in subdivision (b)(1)</u>, the corporation, partnership, limited partnership, limited liability partnership, or limited liability company:</p> <ol style="list-style-type: none"> 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. consumed tangible personal property and failed to pay the applicable tax to the seller or the Board; or 3. issued a receipt for use tax and failed to report and pay the tax. <p>(b) DEFINITION OF TERMS.</p> <p>(1) RESPONSIBLE PERSON. As used herein, the term "responsible person" means any officer, member, manager, employee, director, shareholder, partner, or other person having control or supervision of, or 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 corporation, partnership, limited partnership, limited liability</p>

Agenda – March 30, 2016 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1702.5, *Responsible Person Liability*

Action Item	Staff and Industry's Proposed Regulatory Language
	<p>partnership, or limited liability company in complying with any provision of the Sales and Use Tax Law. <u>The fact that a person possesses any of the aforementioned titles, in and of itself, is not sufficient to establish that the person is a “responsible person.”</u> The term "responsible person" does not include any person who would otherwise qualify but is serving in that capacity as an unpaid volunteer for a non-profit organization.</p> <p>(2) <u>WILLFULLY FAILS TO PAY OR TO CAUSE TO BE PAID.</u> As used herein, the term "willfully fails to pay or to cause to be paid" means <u>that the failure was the result of a</u> voluntary, conscious and intentional <u>course of action.</u> A failure to pay or to cause to be paid may be willful even though such failure was not done with a bad purpose or evil motive. <u>A person has willfully failed to pay the taxes, or to cause them to be paid, only when the Board establishes all of the following:</u></p> <p><u>(A) On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.</u></p> <p><u>(B) The responsible person had the authority to pay the taxes or to cause them to be paid (i) on the date that the taxes came due and (ii) when the responsible person had actual knowledge as defined in (A). A responsible person who was required to obtain approval from another person prior to paying the taxes at issue and was unable to act on his or her own in making the decision to pay the taxes does not have the authority to pay the taxes or to cause them to be paid.</u></p> <p><u>(C) When the responsible person had actual knowledge as defined in (A), the responsible person had the ability to pay the taxes but chose not to do so.</u></p> <p>(3) TERMINATION. As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of <u>all business activities for which the corporation, partnership, limited partnership, limited liability partnership, or limited liability company was required to hold a seller’s permit or</u></p>

Agenda – March 30, 2016 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1702.5, *Responsible Person Liability*

Action Item	Staff and Industry's Proposed Regulatory Language
	<p><u>certificate of registration for the collection of use tax.</u></p> <p>(c) COLLECTION.</p> <p>(1) <u>Once the Board has established the requirements of personal liability in subdivision (a), and further defined in subdivision (b),</u> The Board may issue a Notice of Determination, in the manner provided in Chapter 5 of the Sales and Use Tax Law, for the amount of the personal liability of the responsible person, and penalties and interest shall be added to the amount due as applicable. The Board may collect the amounts due from the responsible person in the manner provided by Chapter 6 of the Sales and Use Tax Law for the collection of sales and use taxes.</p> <p>(2) On or after January 1, 2009, a Notice of Determination shall be mailed within whichever of the following periods expires earlier:</p> <p>(A) Three years after the last day of the calendar month following the quarterly period in which the Board obtains actual knowledge, through its audit or compliance activities, or by written communication by the business or its representative, of the termination, dissolution, or abandonment of the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company; or</p> <p>(B) Eight years after the last day of the calendar month following the quarterly period in which the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company was terminated, dissolved, or abandoned.</p> <p>(3) If a business or its representative files a notice of termination, dissolution, or abandonment of its business with a state or local agency other than the Board, this filing shall not constitute actual knowledge by the Board under this regulation.</p>

Agenda – March 30, 2016 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1702.5, *Responsible Person Liability*

Action Item	Staff and Industry's Proposed Regulatory Language
	<p><u>(d) BURDEN OF PROOF AND STANDARD OF PROOF. In order for a person to be personally liable, the Board has the burden to prove that the requirements of personal liability in subdivision (a), and further defined in subdivision (b), have been satisfied under the preponderance of the evidence standard of proof.</u></p> <p><u>(e) PRESUMPTION. If the person is not an officer or a member or a partner or a manager with an ownership interest in the entity, the person is presumed to not be personally liable under subdivision (a), unless the Board rebuts this presumption with clear and convincing evidence.</u></p>

Issue Paper Number **16-01**



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Regulation 1702.5, *Responsible Person Liability*

I. Issue

Whether the Board should amend Regulation 1702.5, *Responsible Person Liability*, to clarify definitions, explain the applicable standard of proof, and add a rebuttable presumption of when there is no personal liability for certain types of persons.

II. Alternative 1 – Staff Recommendation

Staff recommends the Board approve and authorize publication of the proposed amendments to Regulation 1702.5, *Responsible Person Liability*, as set forth in Exhibit 2. Staff’s proposed revisions:

- Clarify the definitions in subdivision (b) of “responsible person,” “willfully fails to pay or to cause to be paid,” and “termination;”
- Clarify when the Board of Equalization (BOE) may issue a Notice of Determination for personal liability of the responsible person;
- Explain that BOE has the burden of proof and explain the applicable standard of proof; and
- Add a rebuttable presumption that if the person is not a manager with an ownership interest in the entity, an officer, a member, or a partner, the person is presumed to not be personally liable.

For a more detailed explanation of Alternative 1 – Staff Recommendation, refer to section VI of this paper.

Submissions in response to staff’s Second Discussion Paper were received from Ms. Patricia Verdugo of Bewley Lasseben & Miller, LLP (Exhibit 3) and Mr. Jesse McClellan of McClellan Davis, LLC. (Exhibit 4). Staff continued to work with these interested parties following receipt of their submissions, which resulted in staff’s current proposed language as discussed in Section V. Interested parties no longer wish to propose alternative language.

III. Other Alternatives Considered

Do not approve the proposed revisions to Regulation 1702.5.

IV. Background

General

Revenue and Taxation Code (RTC) section 6829 imposes personal liability upon certain persons for the unpaid sales and use tax liabilities of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company (entity). In order to issue a Notice of Determination for personal liability under RTC section 6829 (6829 dual determination), the BOE must establish all of the following:

1. The entity's business has been terminated, dissolved, or abandoned.
2. While the person was a responsible person, the entity sold tangible personal property in the conduct of its business and collected sales tax reimbursement on the selling price and failed to remit such tax when due; consumed tangible personal property and failed to pay the applicable tax to the seller or the BOE; or included use tax on billings and collected use tax or issued a receipt for use tax and failed to report and pay the tax.
3. The person to be held personally liable was a "responsible person."
4. The responsible person willfully failed to pay or to cause to be paid the taxes due from the entity.

Sales and Use Tax Regulation 1702.5, *Responsible Person Liability*, provides further guidance regarding when a person can be held personally liable for the unpaid liabilities of an entity. Guidance regarding 6829 dual determinations is also found in BOE's Compliance Policy and Procedures Manual (CPPM).

Guidance in the BOE CPPM

Procedures for identifying and establishing liability in 6829 dual determinations are provided in CPPM Chapter 7, *Collections*. The CPPM incorporates processes, procedures, and techniques that have evolved over a period of years and that have proven to be effective. In 2013, a workgroup of several BOE Departments, including the BOE's Legal Department, collaborated to revise and update the CPPM guidance on 6829 dual determinations to explain, among other things, the Board's long-standing interpretation of RTC section 6829 and Regulation 1702.5. After being posted for public comment, revised CPPM sections 764.080 – 764.180 were approved by the Board at the March 24, 2014, Board Meeting.

V. Discussion

Liability of Responsible Person – Regulation 1702.5 (a)

The legal interpretation of RTC 6829 and Regulation 1702.5 subdivision (a) has been that a responsible person is personally liable only for liabilities arising from taxable sales and uses that occurred while the person was a responsible person.¹ This is also addressed in CPPM section 764.140, *Establishing the Elements of an RTC Section 6829 Dual Determination – Responsible Person*. In order to provide clarification of this point in the regulation and to address the concerns raised during the interested parties' process, staff proposes revisions to the second paragraph of subdivision (a) to provide that, "Personal liability shall only apply if the Board establishes that while

¹ We note that RTC section 6829 (c) also provides that a responsible person is liable only for the taxes that came due during the period that the person had the control, supervision, responsibility, or duty to act for the entity, plus interest and penalties on those taxes.

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the person was a responsible person, as defined in subdivision (b)(1), the corporation...” (proposed addition underlined). Staff believes that the additions to subdivision (a) and the CPPM text sufficiently address the issue.

Definition of “Responsible Person” – Regulation 1702.5 (b)(1)

Personal liability can only be imposed on a responsible person. RTC section 6829 (a) explains that “any officer, member, manager, partner, or other person having control or supervision of, or who is charged with the responsibility for the filing of returns or the payment of tax” can be personally liable. Regulation 1702.5 subdivision (b)(1) defines a “responsible person” as any officer, member, manager, employee, director, shareholder, partner, or other person having control or supervision of, or 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 entity in complying with any provision of the Sales and Use Tax Law. To clarify the subdivision, staff recommends adding the sentence, “The fact that a person possesses any of the aforementioned titles, in and of itself, is not sufficient to establish that the person is a ‘responsible person.’ ” This addition is similar to information in CPPM section 764.140 which explains the responsible person element, what sources of information should be examined to determine if a person is a responsible person, and which sources are generally given more weight.

Definition of “Willfully Fails to Pay or to Cause to Be Paid” – Regulation 1702.5 (b)(2)

Personal liability can be imposed on a responsible person only if the person willfully fails to pay or to cause to be paid any taxes due from the entity. RTC section 6829 (d) explains that “willfully fails to pay or to cause to be paid” means that the failure was the result of an intentional, conscious, and voluntary course of action. The current text of Regulation 1702.5 subdivision (b)(2) clarifies that a failure to pay or to cause to be paid may be willful even though such failure was not done with a bad purpose or evil motive.

CPPM section 764.150, *Establishing the Elements of an RTC Section 6829 Dual Determination – Willfulness*, provides further guidance by explaining that to prove willfulness there must be evidence of all of the following:

1. The responsible person had knowledge that the taxes were not being paid. Staff may obtain evidence that shows the responsible person had actual knowledge of the tax liability. In cases where staff does not have evidence of actual knowledge, staff can use available evidence, including circumstantial evidence, to show that it is more likely than not that the responsible person knew of the liability (e.g., under the circumstances, the responsible person must have known of the tax liability).
2. The responsible person had the authority to pay taxes or cause them to be paid. Whether a responsible person ever signed checks or even had check signing authority is not dispositive on this element. The crucial question is whether the person had the authority to pay the taxes or direct someone else to pay them.
3. Along with such knowledge and authority, the responsible person had the ability to pay the taxes but chose not to. Staff may show the ability to pay by, among other evidence, the collection of sales tax reimbursement or use tax that was not remitted. The ability to pay may also be shown by payments made to other creditors during or after the relevant periods of liability. Staff does not have to establish that the actual amount of taxes owed was available at any given time. Staff must merely show that funds were, in general, available and not paid to the BOE.

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Staff has included these concepts in its proposed revisions to subdivision (b)(2) and revised the text from earlier drafts during the interested parties process that caused confusion.

Staff's proposed subdivision (b)(2)(A) provides that, "On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid." Staff included "or after" based on concerns that "on the date the taxes came due" could be narrowly interpreted to only refer to the single day that a return was due. That is, staff believes that if a responsible person was absent from the business on the date the return was due, but later became aware that the return was due, but not paid, the knowledge component of willfulness could still be met.

With regard to the authority to pay taxes or cause them to be paid (subdivision (b)(2)(B)), staff believes the responsible person must have had authority both on the date that the taxes came due and when the person acquired actual knowledge that the taxes were due, but not being paid. For example, a month after the due date of the return, a responsible person learns that taxes were due, but not paid. In order to meet the authority component of willfulness, the responsible person must have had the authority to pay the taxes on the day the taxes were due and the month later when the person learned that the taxes were due, but not paid.

With regard to the ability to pay (subdivision (b)(2)(C)), staff believes that when the responsible person has actual knowledge that the taxes were due but not paid, the responsible person must have had the ability to pay the taxes but chose not to do so. By linking all of the components of willfulness to one point in time – when the responsible person has actual knowledge that taxes were due, but not being paid – staff believes it has addressed interested parties' concerns with regard to the willfulness requirement.

In addition to the revisions noted above, staff also recommends revising the title of subdivision (b)(2) from "Willful" to "Willfully Fails to Pay or to Cause to Be Paid" to correspond more closely to the language of RTC section (d) and Regulation 1702.5 (a). Staff further recommends deleting the word "evil" from the phrase, "...was not done with a bad purpose or evil motive" as staff believes the word "bad" is sufficient.

Definition of "Termination" – Regulation 1702.5 (b)(3)

To hold a person personally liable, BOE must establish that the entity's business has been terminated, dissolved, or abandoned. The current text of subdivision (b)(3) explains that "termination" includes discontinuance or cessation of business activities. CPPM section 764.120, *Establishing the Elements of an RTC Section 6829 Dual Determination – Termination, Dissolution, or Abandonment*, explains that "business activities" refers to the activities for which the entity was required to hold a seller's permit or certificate of registration for the collection of use tax.

During the discussion paper and interested parties' process, several suggestions were made about what, if any, revisions were needed to clarify the definitions in subdivision (b)(3). Based on these discussions, staff proposes revisions to include the information from CPPM section 764.120. That is, to clarify "termination" means the discontinuance or cessation of all business activities for which the entity was required to hold a seller's permit or certificate of registration for the collection of use tax.

When Board May Issue Notice of Determination – Regulation 1702.5 (c)(1)

During the interested parties' process, it was suggested that language should be added to the regulation to explain that the BOE must establish the elements of personal liability before issuing a Notice of Determination. CPPM section 764.090, *RTC Section 6829 Overview of Process*, explains this established process and provides details of all of the steps involved before the BOE issues a Notice of

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Determination for personal liability under RTC section 6829. In order to address this issue, staff proposes revising subdivision (c)(1) to clarify that BOE must establish all of the requirements of subdivisions (a) and (b) before it may issue a Notice of Determination for personal liability of the responsible person.

Burden of Proof and Standard of Proof – Proposed Regulation 1702.5 (d)

Currently, Regulation 1702.5 does not include information regarding the BOE long-standing position that it has the burden of proof in establishing the requirements to impose personal liability under RTC section 6829. In addition, Regulation 1702.5 currently does not include information as to the applicable standard of proof. California Evidence Code section 115 states that, except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence. BOE staff has consistently applied the preponderance of evidence standard to these cases since the statute was enacted. The “preponderance of evidence” standard relates to the probability of truth and requires that evidence be “more likely than not” to prove the issue under question. This language is found throughout the CPPM sections on 6829 dual determinations. As RTC section 6829 does not specify a different standard of proof, staff believes the Board does not have the statutory authority to hold itself to a standard of proof other than the preponderance of evidence. To include this long-standing burden and standard of proof into the regulation, staff recommends adding subdivision (d) to explain that, in order for a person to be personally liable, BOE has the burden to prove that the requirements of personal liability in Regulation 1702.5 (a) and (b) have been satisfied under the preponderance of the evidence standard of proof.

Rebuttable Presumption – Proposed Regulation 1702.5 (e)

RTC section 6829 was enacted in 1981 and became effective 1982. Over the many years that section 6829 has existed, the BOE has gained specialized knowledge and experience as it has administered and enforced the provisions of 6829. More specifically, staff has learned what types of evidence it typically obtains to support the elements of personal liability and the strength of these types of evidence. In addition, staff has learned what types of persons are generally not personally liable. Based on this knowledge and experience, staff recommends adding a rebuttable presumption to Regulation 1702.5 so that staff’s efforts in pursuing personal liability are more focused on those persons, whom prior experience has shown, are generally found to be personally liable based on the evidence.

Accordingly, staff recommends adding subdivision (e) to include a rebuttable presumption that provides that if the person is not an officer or a member or a partner or a manager with an ownership interest in the entity, the person is presumed to not be personally liable unless the BOE rebuts the presumption with clear and convincing evidence.

VI. Alternative 1 - Staff Recommendation**A. Description of Alternative 1**

Staff recommends the Board approve and authorize publication of the proposed amendments to Regulation 1702.5, *Responsible Person Liability*, as set forth in Exhibit 2. Staff’s proposed revisions:

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- Clarify key definitions provided in subdivision (b):
 - “Responsible person” – revisions explain that the fact that a person possesses a particular title (e.g., officer, manager, etc.) is not, in and of itself, sufficient to establish that the person is a “responsible person.”
 - “Willfully fails to pay or to cause to be paid” – revisions clarify that the responsible person had actual knowledge that taxes were due, but not being paid; had the authority to pay the taxes or to cause them to be paid; and had the ability to pay the taxes, but chose not to do so.
 - “Termination” – revisions clarify that the term means the discontinuance or cessation of all business activities for which the entity was required to hold a seller’s permit or certificate of registration for the collection of use tax.
- Clarify when the BOE may issue a Notice of Determination for personal liability of the responsible person.
- Explain that in order for a person to be personally liable, the BOE has the burden to prove that the requirements of personal liability in subdivision (a) and (b) have been satisfied under the preponderance of the evidence standard of proof.
- Add a rebuttable presumption that if the person is not an officer or a member or a partner or a manager with an ownership interest in the entity, the person is presumed to not be personally liable unless the BOE rebuts the presumption with clear and convincing evidence.

B. Pros of Alternative 1

- Provides regulatory clarity of key definitions.
- Adds BOE’s long-held position that BOE has the burden to prove that the elements of 6829 dual determinations have been met under the preponderance of evidence standard of proof.
- Adds a rebuttable presumption that certain persons are presumed to not be personally liable in order to focus staff’s efforts on persons who historically have been found to be personally liable.

C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff’s recommendation does require a regulatory change.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1702.5.

F. Administrative Impact of Alternative 1**1. Cost Impact**

The workload associated with publishing the amended regulation is considered routine. Any corresponding costs will be absorbed within the BOE’s existing budget.

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2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff's proposed revisions provide regulatory guidance on the key definitions and the applicable standard of proof in 6829 dual determination cases.

H. Critical Time Frames of Alternative 1

None.

VII. Alternative 2

A. Description of Alternative 2

Do not approve proposed revisions to Regulation 1702.5.

B. Pros of Alternative 2

The BOE will not incur the workload associated with revising the regulation.

C. Cons of Alternative 2

Taxpayers and BOE staff will not have the regulatory clarification provided by the proposed revisions to key definitions and the applicable standard of proof.

D. Statutory or Regulatory Changes for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 2

Taxpayers would not have the regulatory clarity provided by the proposed revisions.

H. Critical Time Frames for Alternative 2

None.

Preparer/Reviewer Information

Prepared by the Tax Policy Division, Business Tax and Fee Department.

Current as of: March 10, 2016

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



Regulation 1702.5, *Responsible Person Liability*

I. Issue

Whether the Board should amend Regulation 1702.5, Responsible Person Liability, to clarify definitions, explain the applicable standard of proof, and add a rebuttable presumption of when there is no personal liability for certain types of persons.

II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of the proposed amendments to Regulation 1702.5, Responsible Person Liability, as set forth in Exhibit 2. Staff's proposed revisions:

- Clarify the definitions in subdivision (b) of “responsible person,” “willfully fails to pay or to cause to be paid,” and “termination;”
- Clarify what requirements BOE must meet in order to issue a Notice of Determination for personal liability of the responsible person;
- Explain the BOE’s burden of proof; and
- Add a rebuttable presumption that if the person is not a manager with an ownership interest in the entity, an officer, a member, or a partner, the person is presumed to not be personally liable.

III. Other Alternative(s) Considered

Do not approve the proposed revisions to Regulation 1702.5.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in the staff recommendation that would impact revenue. The proposed amendments would:

- Provide regulatory clarity of key definitions.

- Explain BOE's long-held position that the Board of Equalization (BOE) has the burden to prove that the elements of 6829 dual determinations have been met under the preponderance of evidence standard of proof.
- Add a rebuttable presumption that certain persons are presumed to not be personally liable in order to focus staff's efforts on persons who historically have been found to be personally liable.

Other Alternatives Considered

There is nothing in Alternative 2 that would impact revenue. However, taxpayers and BOE staff will not have the regulatory clarification provided by the proposed revisions regarding key definitions and BOE's burden of proof.

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

The other alternative considered does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. This estimate has been reviewed by Mr. Mark Durham, Chief, Research and Statistics Section, Legislative and Research Division, and by Ms. Susanne Buehler, Chief, Tax Policy Division, Business Tax and Fee Department. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of March 9, 2016.

REGULATION 1702.5. RESPONSIBLE PERSON LIABILITY.

(a) **GENERAL.** Any responsible person who willfully fails to pay or to cause to be paid, under circumstances set forth below, any taxes due from a corporation, partnership, limited partnership, limited liability partnership, or limited liability company pursuant to Part 1, Division 2, of the Revenue and Taxation Code shall be personally liable for any unpaid taxes and interest and penalties on those taxes not so paid upon termination, dissolution, or abandonment of the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company.

Personal liability shall only apply if the Board establishes that while the person was a responsible person, as defined in subdivision (b)(1), the corporation, partnership, limited partnership, limited liability partnership, or limited liability company:

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. consumed tangible personal property and failed to pay the applicable tax to the seller or the Board; or
3. issued a receipt for use tax and failed to report and pay the tax.

(b) DEFINITION OF TERMS.

(1) **RESPONSIBLE PERSON.** As used herein, the term "responsible person" means any officer, member, manager, employee, director, shareholder, partner, or other person having control or supervision of, or 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 corporation, partnership, limited partnership, limited liability partnership, or limited liability company in complying with any provision of the Sales and Use Tax Law. The fact that a person possesses any of the aforementioned titles, in and of itself, is not sufficient to establish that the person is a "responsible person." The term "responsible person" does not include any person who would otherwise qualify but is serving in that capacity as an unpaid volunteer for a non-profit organization.

(2) **WILLFULLY FAILS TO PAY OR TO CAUSE TO BE PAID.** As used herein, the term "willfully fails to pay or to cause to be paid" means that the failure was the result of a voluntary, conscious and intentional course of action. A failure to pay or to cause to be paid may be willful even though such failure was not done with a bad purpose or ~~evil~~ motive. A person has willfully failed to pay the taxes, or to cause them to be paid, only when the Board establishes all of the following:

(A) On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.

(B) The responsible person had the authority to pay the taxes or to cause them to be paid (i) on the date that the taxes came due and (ii) when the responsible person had actual knowledge as defined in (A). A responsible person who was required to obtain approval from another person prior to paying the taxes at issue and was unable to act on his or her own in making the decision to pay the taxes does not have the authority to pay the taxes or to cause them to be paid.

(C) When the responsible person had actual knowledge as defined in (A), the responsible person had the ability to pay the taxes but chose not to do so.

(3) TERMINATION. As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of all business activities for which the corporation, partnership, limited partnership, limited liability partnership, or limited liability company was required to hold a seller's permit or certificate of registration for the collection of use tax.

(c) COLLECTION.

(1) Once the Board has established the requirements of personal liability in subdivision (a), and further defined in subdivision (b), ~~F~~the Board may issue a Notice of Determination, in the manner provided in Chapter 5 of the Sales and Use Tax Law, for the amount of the personal liability of the responsible person, and penalties and interest shall be added to the amount due as applicable. The Board may collect the amounts due from the responsible person in the manner provided by Chapter 6 of the Sales and Use Tax Law for the collection of sales and use taxes.

(2) On or after January 1, 2009, a Notice of Determination shall be mailed within whichever of the following periods expires earlier:

(A) Three years after the last day of the calendar month following the quarterly period in which the Board obtains actual knowledge, through its audit or compliance activities, or by written communication by the business or its representative, of the termination, dissolution, or abandonment of the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company; or

(B) Eight years after the last day of the calendar month following the quarterly period in which the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability company was terminated, dissolved, or abandoned.

(3) If a business or its representative files a notice of termination, dissolution, or abandonment of its business with a state or local agency other than the Board, this filing shall not constitute actual knowledge by the Board under this regulation.

(d) BURDEN OF PROOF AND STANDARD OF PROOF. In order for a person to be personally liable, the Board has the burden to prove that the requirements of personal liability in subdivision (a), and further defined in subdivision (b), have been satisfied under the preponderance of the evidence standard of proof.

(e) PRESUMPTION. If the person is not an officer or a member or a partner or a manager with an ownership interest in the entity, the person is presumed to not be personally liable under subdivision (a), unless the Board rebuts this presumption with clear and convincing evidence.

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December 30, 2015

Sent Via U.S. Mail and Email (Susanne.Buehler@boe.ca.gov)

Ms. Susanne Buehler, Chief
Tax Policy Division
State Board of Equalization
450 N Street, MIC: 92
Sacramento, CA 95814

Re: Proposed Amendments to California Code of Regulations, title 18, section 1702.5,
Responsible Person Liability

Dear Ms. Buehler:

This submission is being made in response to the Second Discussion Paper issued on December 14, 2015, regarding proposed amendments to Regulation 1702.5. The Staff's Proposed Amendments to Regulation 1702.5, as presented in Exhibit 1 of the Second Discussion Paper (the "Proposed Language"), and additional suggested language is discussed below.

I. Subdivision (b)(1), *Responsible Person*.

The first sentence of subdivision (b)(1) of Regulation 1702.5 provides that a "responsible person" means any "officer, member, manager, employee, director, shareholder, partner, or other person" having the requisite control or supervision or responsibility or duty to act. The Proposed Language adds immediately thereafter that "[t]he fact that a person possesses the title of officer, member, or partner, in and of itself, is not sufficient to establish that the person is a 'responsible person.'" We agree with the addition of this Proposed Language with one change: the titles should include all titles listed in the first sentence, as follows:

The fact that a person possesses the title of officer, member, manager, employee, director, shareholder, or partner, in and of itself, is not sufficient to establish that the person is a "responsible person."

There does not appear to be any reason why the complete list of titles in the first sentence should not be included in the second sentence. In other words, like the included titles, the excluded titles are not, in and of themselves, sufficient to establish liability.

II. Subdivision (b)(2), *Willfully Fails to Pay or to Cause to be Paid.*

A. The Proposed Language in subdivision (b)(2) was revised from the proposed language in the Initial Discussion Paper issued on October 22, 2015, at least partially in response to comments from interested parties. Although we generally agree with the revisions, we note that, as revised, the Proposed Language in subdivision (b)(2)(A) and subdivision (b)(2)(B), are not consistent. Subdivision (b)(2)(A) (dealing with the knowledge element) begins with the phrase “On or after the date that the taxes came due,” whereas subdivision (b)(2)(B) (dealing with the element of authority) begins with the phrase “On the date that the taxes came due.” We see no reason why the time period for one element should be different from the time period for another element, and we believe that this inconsistency will create confusion and unintended consequences.

In order to avoid confusion, subdivision (b)(2)(A) and (b)(2)(B) should begin with the same phrase, “On the date that the taxes came due.”

B. Furthermore, with respect to the knowledge element in subdivision (b)(2)(A), we agree with other interested parties that evidence of actual knowledge is required. Although we generally agree with the revisions to this subdivision, the revised Proposed Language in subdivision (b)(2) would better reflect this requirement as stated below:

(A) On the date the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.

C. We note and generally agree with the Staff’s position against adding language that would impose a greater liability on banks and financial institutions. In the Second Discussion Paper, the Staff’s reasoning is supported by the following:

Staff further notes that the fact that a bank or financial institution has stepped into the role of managing a business’ accounts payable or accounts receivable may be used as a defense to the element of willfulness. For example, a responsible person may argue that he/she did not act willfully in not paying the taxes due because the entity’s bank had taken complete control over its bank account.

We, like the Staff, are aware of cases where taxpayers have lost control of their bank accounts to financial institutions that are aware that funds in the accounts need to be paid to the Board, but who nonetheless refuse or otherwise fail to release the funds for such payment. However, despite the Staff’s statements above, currently, such cases do not appear to be treated consistently by the audit staff against similarly-situated taxpayers. For this reason, we believe the Regulation or other guidance should make it clear that under these circumstances, the taxpayer does not act “willfully.”

III. Subdivision (d), *Burden of Proof.*

We agree that the Regulation should state the burden of proof. We relate our experience with at least one auditor who indicated to us and our client that the burden of proof is on the taxpayer to show “beyond a reasonable doubt” (which was interpreted by the auditor as no doubt at all) that the taxpayer was not a responsible person. This burden of proof was clearly erroneous

and arguably abusive. Stating the burden of proof within the Regulation will provide needed guidance to both staff and taxpayers. However, we believe that the standard of proof should be “clear and convincing evidence” and not the proposed “preponderance of the evidence” standard of proof.

Although the “preponderance of the evidence” standard of proof is arguably the correct standard for sales and use tax cases in general, we believe the Department should be held to a higher standard when imposing this onerous liability. Where a person has the requisite responsibility or duty to act and willfully fails to do so, that person should be held liable for the tax, and the staff should have no problem making the case by clear and convincing evidence. However, the low standard of proof historically used by the staff in making these personal liability determinations resulted in relatively innocent individuals being held liable where the true responsible parties escaped liability. We have seen cases where multimillionaire owners walk away from the defunct business without being held personally liable, while employees who lost their jobs when the company failed are forced to pay the company’s unpaid taxes. In our experience, it is usually those individuals who are the most vulnerable (e.g., they are unable to pay for legal counsel, are not residents of the state, and/or are the least aware of their rights) who end up holding the proverbial bag. For these reasons, and with all due respect to conscientious audit staff, we believe that a standard of proof of “clear and convincing evidence” will provide better guidance to staff and provide the necessary protection to innocent taxpayers.

IV. Subdivision (e), *Presumption of No Personal Liability*.

We generally agree and welcome the presumption in subdivision (e), but request some clarification. As drafted, it appears that any person who does not have an ownership interest in the entity would be presumed not to be personally liable. As such, we propose the following modified language:

If a person does not have an ownership interest in the entity, the person is presumed to not be personally liable under subdivision (a), unless the Board rebuts this presumption by proving that the requirements of personal liability in subdivision (a), and further defined in subdivision (b), have been satisfied under the clear and convincing evidence standard of proof.

Notably, similar to the proposed addition in subdivision (b)(1) above, not all “titles” are listed in subdivision (e). As a result, the presumption also appears to apply where a person has an ownership interest in the entity, but does not also hold the title of “officer, member, partner, or manager.” We would support this interpretation as being consistent with the intent to limit liability to persons who have the requisite control and responsibility. For example, a rank and file employee or a director who has an ownership interest in the entity through the entity’s incentive stock plan, but who is not “an officer, member, partner, or manager”, would be presumed not to be personally liable. If the above interpretation is correct, we propose the following language in addition to the language stated above:

In addition, if a person has an ownership interest in the entity, but the person is not an officer, member, partner, or manager of the entity, the person is presumed to not be personally liable under subdivision (a), unless the Board rebuts this

presumption by proving that the requirements of personal liability in subdivision (a), and further defined in subdivision (b), have been satisfied under the clear and convincing evidence standard of proof.

Thank you for allowing us to provide the above comments and suggestions.

Sincerely,

BEWLEY, LASSLEBEN & MILLER



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January 21, 2016

Ms. Susanne Buehler, Chief
Board of Equalization
Tax Policy Division
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450 N Street
Sacramento, CA 94279-0092

VIA: Email: Susanne.Beuhler@boe.ca.gov

Re: Proposed amendments to California Code of Regulations, title 18, section 1702.5,
Responsible Person Liability.¹

Dear Ms. Buehler,

This submission is being made in response to the Second Discussion Paper (SDP) and the second interested parties meeting (2nd IPM) held on January 7, 2016, regarding proposed amendments to Regulation 1702.5.

As you are aware, additional issues were raised at the 2nd IPM which we believe were useful to this process. The Taxpayers' Rights Advocate Office expressed a desire to add language that would help taxpayers to better understand that a close out of their business is sufficient to trigger collection action under Revenue and Taxation Code section 6829, *Personal Liability of Corporate Officer*.² There was also discussion regarding the standard of proof that applies to establishing the requirements under Code section 6829, and Ms. Patricia Verdugo made a submission that addresses that issue, among others. We support both of those proposed changes and address them here for your consideration.

¹ All references to Regulations hereafter are to California Code of Regulations, title 18, unless otherwise noted.

² All references to Code sections hereafter are to Revenue and Taxation Code sections unless otherwise noted.

Regulation 1702.5, subdivision (b)(3), Termination:

Subdivision (b)(3) addresses the “termination” requirement under Code section 6829, a threshold element that must be established in order to pursue a responsible person of the entity. In relevant part, Code section 6829, subdivision (a) provides:

“Upon the termination, dissolution, or abandonment of **the business of** a corporation, partnership, limited partnership, limited liability partnership or limited liability company...” (Bolding added)

Code section 6829 was amended in 2008 to add “the business of,” among other changes. The intent of the amendment was to permit personal collection action upon the close out of the business of an entity. To help taxpayers understand that they may be personally pursued upon the closeout of the business, even if the entity remains intact, the Taxpayers’ Rights Advocate (TRA) made a submission recommending that the following (underlined) language be added to 1702.5, subdivision (b)(3):

As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of business activities. “Business activities” means the activities for which the entity was required to hold a seller’s permit or certification of registration for the collection of use tax. There is no requirement that the entity itself cease to exist or even cease doing business in some other manner or in some other state.

We agree that it would be beneficial to put taxpayers on notice that they may be pursued personally upon the close out of the business, even if the underlying entity remains intact. We also agree with interested parties’ comments regarding the need to help ensure that BOE staff is exhausting its collection remedies against the entity, before it resorts to the extraordinary option of pursuing one or more responsible individuals of the entity. Moreover, we believe the language of the statute requires that “the business” of the entity actually cease in its entirety before personal liability collection efforts ensue. In other words, personal collection efforts should not be pursued in a situation where an entity merely closes one or more of several permits it holds, when the entity continues to operate “the business” of the entity under one or more other permits. Just because a business is required to hold more than one permit, e.g., an auto dealership with multiple locations, a close out of one location with a separate seller’s permit does

not constitute a termination of “the business of” the entity. If the legislature intended to allow personal collection where a single permit of the entity was closed, we believe it would have made that clear in the statute. For example, the statute could have been amended to provide that termination of “[a] business” of the entity, or termination of “[a permit]” of the entity, is sufficient to trigger personal collection action. No such amendment was made in the statute which supports that the legislature did not intend to open the door to personal liability collection, upon the mere closure of a business location/sub-permit.

We understand that Board Staff has concerns with taxpayers maintaining a shell entity in an effort to avoid personal collection, but we don’t believe our suggested language (below) will negatively impact that concern. Pursuant to Code section 6829, subdivision (f), the Board is provided with authority to pursue personal collection for up to three years from the date “...the board obtains actual knowledge, through its audit or compliance activities, or by written communication by the business or its representative, of the termination, dissolution, or abandonment of the business of the [entity]...” Under the circumstances (where an entity is in place), a liability of the business is issued against the underlying entity. Therefore, if “the business” of the entity ceases in its entirety at some point after one or more permits are closed, the Board would still have the authority to pursue personal collection efforts, for any sales and use tax liability stemming from any permit held by the entity, for three years following the date it obtains actual knowledge of the cessation. During the period in which the entity continues the business activities, the Board would have full authority to pursue any liability associated with the closed permit(s) against the ongoing entity. No collection ability would actually be lost, the administration of the law would be more consistent with the language of Code section 6829, and individuals would not be forced to unduly endure the significant burdens that accompany personal collection efforts while the business of the entity continues. Therefore, we recommend adding the following (underlined) language to Regulation 1702.5, subdivision (b)(3):

As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of business activities. “Business Activities” means the activities for which the entity was required to hold a seller’s permit or certification of registration for the collection of use tax. There is no requirement that the entity itself cease to exist or even cease doing business in some other manner or in some other state.

Termination does not occur when the corporation, partnership, limited partnership, limited liability partnership, or limited liability

company continues the business activities for which it was required to hold a seller's permit or certification of registration for the collection of use tax, under a separate permit or registration.

There was also discussion about clarifying the Board's policy of exhausting all available collection remedies against the entity where the entity remains active in a different line of business for which no permit is required, or remains intact without an active business, but still has available assets. We agree that language should be added to the Regulation to address that requirement.

Regulation 1702.5, subdivision (e), *Presumption of No Personal Liability*; subdivision (d) *Burden of Proof*:

Subdivision (e), currently provides:

“If the person is not an officer, member, partner, or manager with an ownership interest in the entity, the person is presumed to not be personally liable under subdivision (a), unless the Board rebuts this presumption with clear and convincing evidence.”

Staff explained that a heightened clear and convincing standard is warranted for individuals that are not an officer, member, partner, or manager with an ownership interest in the entity because its experience in administering Code section 6829, has demonstrated that non-officer/owners typically are not the individuals that have true authority, and typically do not benefit from the failure to pay a liability. We agree with Staff in this regard. We believe, however, that a heightened standard of proof should apply to all individuals.

It is well settled that a clear and convincing standard of proof applies to fraud cases. (*Marchica v. State Board of Equalization* (1951) 107 Cal.App.2d, 501.) At least one reason why a clear and convincing standard is applied in fraud cases, is because it is a severe allegation with significant ramifications. The same is true for personal liability. Holding an individual responsible for the liability of a terminated entity, arguably creates a more severe economic burden than a fraud penalty that is issued against an ongoing concern. Given the extraordinary circumstances involved in personal liability cases, we believe a heightened standard of proof should apply in all Code section 6829 cases.

We understand that BOE Staff has concerns about its authority to apply a heightened standard to all personal liability cases. We were unable, however, to locate any legal authority

which would clearly preclude the Board of Equalization from applying a heightened standard of proof to personal liability cases through its administrative rule making authority. As stated in *Wallace Berrie & Co. v. State Board of Equalization* (1985) 40 Cal.3d 60, 65, when reviewing the validity of a regulation the "...inquiry necessarily is confined to the question whether the classification is 'arbitrary, capricious or without reasonable or rational basis.'" As explained, there is a reasonable and rational basis to apply a clear and convincing standard to personal liability cases, and doing so does not alter, narrow or expand any of the underlying legal elements. It merely provides an added safeguard that will help to ensure that the individuals pursued, are actually responsible under the law. In an effort to help protect individuals that should not be pursued, we ask the Staff to apply a clear and convincing standard in all Code section 6829 cases.

Our suggested language that would be more appropriately placed under subdivision (d), *Burden of Proof*, follows:

In order for a person to be personally liable, the Board has the burden to prove that the requirements of personal liability which are described in subdivision (a), and further defined in subdivision (b), have been satisfied under the clear and convincing standard of proof.

We thank you for providing us with the opportunity to submit these suggestions. Please don't hesitate to contact me with any questions or comments.

Sincerely,



Jesse W. McClellan, Esq.
Principal