



**STATE BOARD OF EQUALIZATION**

450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092  
1-916-324-1825 • FAX 1-916-322-4530  
[www.boe.ca.gov](http://www.boe.ca.gov)

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Executive Director

December 18, 2015

Dear Interested Party:

Enclosed is the Second Discussion Paper on Regulation 1702.5, *Responsible Person Liability*. Before the issue is presented at the Board's March 29, 2016 Business Taxes Committee meeting, staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, a second interested parties meeting is scheduled as follows:

**January 7, 2016  
Room 122 at 10:00 a.m.  
450 N Street, Sacramento, CA**

If you would like to participate by teleconference, call 1-888-808-6929 and enter access code 7495412. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at [Susanne.Buehler@boe.ca.gov](mailto:Susanne.Buehler@boe.ca.gov) by January 22, 2016. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

If you are interested in other Business Taxes Committee topics refer to our webpage at (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of discussion or issue papers, minutes, a procedures manual, and calendars arranged according to subject matter and by month.

Thank you for your consideration. We look forward to your comments and suggestions. Should you have any questions, please feel free to contact our Business Taxes Committee staff member, Ms. Lynn Whitaker, at 1-916-324-8483, who will be leading the meeting.

Sincerely,

Susanne Buehler, Chief  
Tax Policy Division  
Sales and Use Tax Department

SB:lw

Enclosures

cc: (all with enclosures, via email and/or hardcopy as requested)

Honorable Jerome E. Horton, Chairman, Third District  
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Honorable Fiona Ma, CPA, Member, Second District  
Honorable Diane L. Harkey, Member, Fourth District  
Honorable Betty T. Yee, State Controller, c/o Ms. Yvette Stowers (MIC 73)  
Ms. Kari Hammond, Board Member's Office, Third District  
Ms. Shellie Hughes, Board Member's Office, Third District  
Ms. Camille Dixon, Board Member's Office, Third 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  
Mr. Jim Kuhl, Board Member's Office, Second District  
Ms. Kathryn Asprey, Board Member's Office, Second District  
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Mr. Tim Morland, Board Member's Office, Second District  
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Mr. Todd Gilman (MIC 70)  
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Mr. Kevin Hanks (MIC 49)  
Mr. Mark Durham (MIC 67)  
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Mr. Chris Lee (MIC 101)  
Ms. Laureen Simpson (MIC 70)  
Ms. Karina Magana (MIC 47)  
Mr. Bradley Miller (MIC 92)  
Mr. Bill Benson (MIC 67)  
Mr. Robert Wilke (MIC 50)

## SECOND DISCUSSION PAPER

### Regulation 1702.5, *Responsible Person Liability*

#### Issue

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

#### Staff Recommendation

Staff proposes revisions to Regulation 1702.5 as provided in Exhibit 1. Staff's proposed revisions:

- Clarify the definitions of "responsible person" and "willful,"
- Explain the Board's burden of proof, and
- Add a rebuttable presumption providing a rebuttable presumption of no personal liability in certain situations.

#### Other Alternatives Considered

Submissions were received from Mr. Rex Halverson and Mr. Jesse McClellan providing alternative regulatory language to the proposed language in staff's initial discussion paper (see Exhibits 2 and 3 respectively). Those alternative suggestions are presented in the Discussion section of this paper.

#### 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 Board of Equalization (BOE) must establish all of the following:

1. The entity's business has been terminated, dissolved, or abandoned.
2. That, 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. That the person to be held personally liable was a "responsible person."
4. That the responsible person willfully failed to pay or to cause to be paid the taxes due from the entity.

## SECOND DISCUSSION PAPER

### Regulation 1702.5, Responsible Person Liability

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 is 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.

#### **Discussion**

Staff met with interested parties on October 22, 2015. After receiving input from outside parties and internal staff during and after the meeting, staff determined it would be better to simplify some of our proposed revisions. Responsible person liability is fact specific and determinations are made on a case by case basis. Since it would not be possible for a regulation to address all of the factual nuances for all potential responsible person liability cases, staff believes a simplified structure to some definitions provides a more easily understood regulation. Staff's revisions are discussed below.

#### 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(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. Regulation 1702.5 (b)(1) also clarifies that "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.

CPPM section 764.140 further 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. While generally the CPPM information is too detailed to include in a regulation, staff recommends one statement be added to the Regulation to clarify the regulatory definition of "responsible person." Staff recommends adding the sentence: "The 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.'" (see Exhibit 1). While neither

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### Regulation 1702.5, Responsible Person Liability

of the interested parties disagreed with this addition, Mr. Halverson suggested additional language to include banks and financial institutions in the definition of “responsible person.”

#### Banks and Financial Institutions – Regulation 1702.5 (b)(1) and (b)(2)

In his submission, Mr. Halverson explains that the definition of “responsible person” should include banks and financial institutions “to put these types of businesses on notice that the Board can and will pursue them if they place themselves into the position of managing the accounts payable and/or accounts receivable of a debtor and fail to pay sales or use tax due the Board of Equalization when due or later upon discovery that any sales or use taxes have not been remitted to the BOE and gross receipts continue to be collected from customers.” Mr. Halverson also recommended revisions to Regulation 1702.5 (b)(2) (regarding the definition of willfulness) to include a presumption that a bank or financial institution is willful if it had the ability to pay taxes due but chose not to (see Exhibit 2).

As to the suggested language for subdivision (b)(1), while staff is aware of cases with the circumstances described in Mr. Halverson’s submission, staff would consider this revision an expansion of the statutory definition of “responsible person” and did not include the suggestion in its proposed revisions. Staff believes that a responsible person must meet the requirements explained in the first sentence of Regulation 1702.5 (b)(1); that is, have “ ...the control or supervision of, or ... [be] 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.” The fact that a bank or financial institution steps into the role of managing the accounts payable or accounts receivable of a debtor company is not sufficient to make the bank or financial institution a responsible person. Staff notes that the existing language of Regulation 1702.5 (b)(1) includes “other person” in the definition of responsible person. This provision would allow the BOE to currently determine that a bank or financial institution is a responsible person if the facts and circumstances of the situation warranted such action.

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. However, a bank or financial institution would not become automatically liable as a responsible person just because the BOE determines that the potential responsible person is not liable due to the bank or financial institution’s actions.

Since staff did not include the suggested language in subdivision (b)(1), staff also did not include the suggested language in subdivision (b)(2), which adds a presumption for banks and financial institutions in the definition of willfulness. Staff also notes that this presumption would lower the Board’s burden only with respect to banks and financial institutions (i.e., the Board only has to prove the ability to pay element and not the other two elements of willfulness), which results in treating banks and financial institutions differently than other responsible persons. Finally, staff notes that, in order to be willful, a responsible person has to know that the taxes were not being paid and have the authority to pay the taxes. It is not sufficient for the responsible person

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### Regulation 1702.5, Responsible Person Liability

to just have the ability to pay. We do not believe that there is a basis in policy or law for treating banks and financial institutions differently.

#### 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. Regulation 1702.5 (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 motive.

In the initial discussion paper, staff recommended additional text based on the provisions of CPPM section 764.150 which provides 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.

In the initial discussion paper, staff suggested adding language to Regulation 1702.5 (b)(2) that included the main concepts of the CPPM provisions. However, that language caused confusion and was not supported by interested parties. After review, staff also noted that the phrase “at the time the taxes came due,” which was included in the previously proposed subdivision 1702.5 (b)(2)(A), could be narrowly interpreted to only refer to the single day that a return was due. Staff has revised its proposed language to address these concerns (see Exhibit 1).

#### Definition of “Termination” – Regulation 1702.5 (c)

To hold a person personally liable, BOE must establish that the entity’s business has been terminated, dissolved, or abandoned. In the initial discussion paper, staff recommended adding language from the CPPM to clarify the meaning of “business activities.” However, when the

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### Regulation 1702.5, Responsible Person Liability

issue was discussed at the interested parties meeting, concerns were raised about whether that clarification was needed in the regulation. Staff agrees that its suggested revisions are not required and now recommends no revision to the current text of Regulation 1702.5 (b)(3).

#### Burden of Proof – Proposed Regulation 1702.5 (d)

Currently, Regulation 1702.5 does not include information regarding the BOE's burden of proof in establishing the requirements to impose personal liability under RTC section 6829. However, BOE has held staff to the preponderance of evidence standard 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. To include this long-standing standard into the regulation, staff and interested parties recommend a new subdivision be added to Regulation 1702.5 to explain BOE's burden of proof (see Exhibit 1). Interested parties agreed with this addition.

#### Rebuttable Presumption of No Personal Liability – 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 a rebuttable presumption providing that 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 unless the BOE rebuts the presumption with clear and convincing evidence (see Exhibit 1). In the initial discussion paper, staff recommended that this administrative policy change be prospective. However, staff believes that the impact of the change is minimal and has not included a prospective date in its current proposed language. Although interested parties agreed with staff's proposal to add a rebuttable presumption, they recommended that the presumption in proposed subdivision (e) be expanded to include cases where the underlying liability stems from a failure to pay use tax on the consumption of tangible personal property. Mr. McClellan included the July 1, 2016 prospective date in his submission, while Mr. Halverson did not include a prospective date (see Exhibits 2 and 3).

#### Use Tax from the Consumption of Tangible Personal Property – Proposed Regulation 1702.5 (e)

RTC section 6829 (c) provides that personal liability may be imposed only if the Board can establish that the entity "had included tax reimbursement in the selling price of, or added tax reimbursement to the selling price of, tangible personal property sold in the conduct of its business, or when it can be established that the [entity]...consumed tangible personal property

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and failed to pay the tax to the seller or has included use tax on the billing and collected the use tax or has issued a receipt for the use tax and failed to report and pay use tax.”

The situation discussed at the interested parties meeting and in Mr. Halverson’s submission is a construction contractor that consumes materials purchased ex-tax from outside California and owes use tax rather than sales tax when materials are pulled out of inventory and used on a job site. Mr. McClellan’s submission explained his belief that a circumstance in which a taxpayer fails to pay use tax due on the consumption of goods is different from a circumstance in which an individual fails to remit tax that was collected. Accordingly, he proposes that Regulation 1702.5 (e) include a favorable presumption and a higher standard of proof when there is a failure to pay use tax on the consumption of goods.

Mr. Halverson explained his belief that RTC section 6829 does not specifically address the scenario where the construction contractor buys materials out of state and then uses them on a job but does not bill use tax or collect use tax from its customer and does not provide the customer with a receipt for use tax. In his opinion, the Legislature did not intend for personal liability to attach to the consumer that must pay use tax on materials yet does not bill use tax, or collect use tax, or provide a receipt for use tax to its customers. Mr. Halverson also explained that he does not believe there is any reason to omit taxpayers that received their Notices of Determination prior to July 1, 2016, since the statute never even comprehended that it might be applied to taxpayers paying use tax as consumers under the facts discussed in the construction contractor scenario.

Staff believes that RTC section 6829 includes all use tax liabilities and did not include the interested parties’ suggestions in its proposed language. By adding the rebuttable presumption, staff intended to address certain types of *persons* who experience has shown have not been found to be personally liable. Staff is concerned that the proposed language would essentially provide preferential treatment to certain types of *businesses*, in particular, construction contractors. We do not believe there is a basis in policy or law for treating potential responsible persons of different business types differently.

### Summary

Staff welcomes any comments, suggestions, or other input on this issue. Staff invites interested parties to participate in the January 7, 2016, interested parties meeting. The deadline to provide written responses regarding this discussion paper is January 22, 2016.

Prepared by the Tax Policy Division, Sales and Use Tax Department  
Current as of 12/14/2015

## 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 the title of officer, member, or partner, 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 knowledge that the taxes were due, but not being paid.

(B) On the date that the taxes came due, the responsible person had the authority to pay the taxes or to cause them to be paid. 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) 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 business activities.

**(c) COLLECTION.**

(1) 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. 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 OF NO PERSONAL LIABILITY.** 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.

**Rex Halverson & Associates, LLC**

*State & Local Tax Advocacy & Consulting*

1201 K St., Suite 1990  
Sacramento, CA 95814-3924  
(916) 444-0015 Tel  
(916) 246-8252 Fax

November 9, 2015

VIA: Email: [Susanne.Buehler@boe.ca.gov](mailto:Susanne.Buehler@boe.ca.gov)

Ms. Susanne Buehler  
Chief  
State Board of Equalization  
Tax Policy Division (MIC:92)  
Tax & Fee Administration Department  
PO Box 942879  
Sacramento, CA 94279-0092

RE: *Comments & Suggestions on Proposed Revisions to Regulation 1702.5,  
Responsible Person Liability*

Dear Ms. Buehler:

Thank you for soliciting comments and suggestions regarding the proposed revisions to Regulation 1702.5, Responsible Person. This submission is being made in response to the Initial Discussion Paper issued on October 22, 2015 and the interested parties meeting held on that same date regarding proposed amendments to Regulation 1702.5. I apologize for not getting this to you by the November 6 deadline but I was attending the California Tax Policy Conference in San Diego on that date and thank Board staff for granting me an extension in which to submit my proposed amendments.

At the interested parties meeting I offered two additional proposed amendments for consideration by BOE staff and elected members. Those amendments concerned (1) banks and financial institutions that step into the role of managing the account payable and/or accounts receivable of a debtor company; and, (2) construction contractors that acquire most of their materials out-of-state and thus must pay use tax to the Board when those materials are taken out of inventory. The language for my proposed amendments is attached.

The language related to banks and financials is needed to put these types of businesses on notice that the Board can and will pursue them if they place themselves into the position of managing the accounts payable and/or accounts receivable of a debtor and fail to pay sales or use tax due the Board of Equalization when due or later upon discovery that any sales or use taxes have not been remitted to the BOE and gross receipts continue to be collected from customers.

Ms. Susanne Buehler  
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The language related to construction contractors is needed to raise the burden of proof required to find an officer, member, partner, or manager of such an entity personally liable if the entity purchases its materials out of state and owes use tax rather than sales tax to the BOE when materials are pulled out of inventory and used on a job site. Such liability is not apparent immediately but flows through the books and records at a much slower rate. Accordingly, the willfulness of nonpayment is far less obvious than the typical retailer that charges and collects sales tax reimbursement and then fails to pay the collected taxes that he has in his bank account to the BOE.

Furthermore, Revenue and Taxation Code section 6829, subdivision (c) provides in full:

Personal liability may be imposed pursuant to this section, only if the board can establish that the corporation, partnership, limited partnership, limited liability partnership, or limited liability company had included tax reimbursement in the selling price of, or added tax reimbursement to the selling price of, tangible personal property sold in the conduct of its business, or when it can be established that the corporation, partnership, limited partnership, limited liability partnership, or limited liability company consumed tangible personal property and failed to pay the tax to the seller or has included use tax on the billing and collected the use tax or has issued a receipt for the use tax and failed to report and pay use tax.

Emphasis Added.

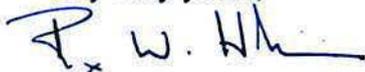
Nowhere in the above language does it address the case described in my scenario, i.e., where a construction contractor buys materials out of state and then uses them on a job but does not bill use tax, or collect use tax from its customer and does not provide the customer with a receipt for use tax. In my humble opinion, the Legislature **never** intended for personal liability to attach to the consumer that must pay use tax on materials yet does not bill use tax, or collect use tax, or provide a receipt for same to its customers.

Although I personally would prefer a total exemption for such construction contractors, I can live with merely raising the burden of proof so my proposed amendment does that. I have also deleted the language spelling out that the change is applicable only to Notices of Determination issued after July 1, 2016 as there is no reason to omit taxpayers that received their Notices prior to that date since the statute never even comprehended that it might be applied to taxpayers paying use tax as consumers under the facts that I have spelled out above.

Ms. Susanne Buehler  
Board of Equalization  
November 9, 2015  
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For all of the above reasons, we respectfully request that Board staff consider adding the suggested language set forth herein to the proposed Regulation 1702.5 in order to clarify the regulation. Thank you for your kind consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read "R. W. Halverson". The signature is written in a cursive style with a large initial "R" and a long horizontal stroke at the end.

Rex W. Halverson

Attachment

Reg. 1702.5 RESPONSIBLE PERSON LIABILITY

Add the following language to subdivision (b) (1) RESPONSIBLE PERSON, following the second sentence:

Responsible person may also include a bank or financial institution that has stepped into the role of managing accounts payable or receivable of a debtor company that is experiencing financial hardships or pending bankruptcy.

Add the following language to subdivision (b)(2) WILLFULLY FAILS TO PAY OR CAUSE TO BE PAID:

A person (*other than a bank or financial institution*) has willfully failed to pay the taxes, or cause them to be paid, only when the Board establishes all of the following:

- (A)...
- (B)...
- (C)...

In the case of a bank or financial institution, it shall be presumed that it has willfully failed to pay the taxes, or cause them to be paid, when the Board establishes solely (C) directly above.

Add the following language to subdivision (e) PRESUMPTION OF NO PERSONAL LIABILITY:

For a Notice of Determination issued against a responsible person, ~~after July 1, 2016~~, if the underlying liability stems from a failure to pay use tax due on the consumption of tangible personal property, or 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.



**MCCLELLAN DAVIS, LLC**  
SALES AND USE TAX SPECIALISTS

508 GIBSON DRIVE, SUITE 120  
ROSEVILLE, CA 95678  
(855) 995-6789 | (916) 788-0999  
FAX (916) 788-0989 | WWW.SALESTAXHELP.COM  
JMcCLELLAN@SALESTAXHELP.COM

November 9, 2015

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

VIA: Email: [Susanne.Beuhler@boe.ca.gov](mailto:Susanne.Beuhler@boe.ca.gov)

Re: Proposed amendments to California Code of Regulations, title 18, section 1702.5,  
*Responsible Person Liability*.<sup>1</sup>

Dear Ms. Buehler,

This submission is being made in response to the Initial Discussion Paper (IDP) issued on October 22, 2015 and the interested parties meeting (meeting/IPM) held on October 22, 2015 regarding proposed amendments to Regulation 1702.5. We also address the Alternative Proposed Language (APL) presented at the meeting.

With a few exceptions as described below, we believe the APL most accurately describes the language and intent of Revenue and Taxation Code section 6829, *Personal Liability of Corporate Officer*.<sup>2</sup> Each proposed subdivision that differs between the IDP and APL is addressed below.

**Subdivision (b)(2)(A) (sub-element of “willfully fails”)**

Proposed language:

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

<sup>2</sup> All references to Code sections hereafter are to Revenue and Taxation Code sections unless otherwise noted.

IDP: “*At the time the taxes came due, the responsible person knew or must have known that the taxes were not being paid. Evidence of actual knowledge is not required. It is sufficient if the Board can establish that it is more likely than not that the responsible person knew of the liability.*”

APL: “*At the time the taxes came due, the responsible person knew that the taxes were not being paid. Knowledge can be established using the available evidence, including circumstantial evidence, showing that it is more likely than not that the person actually knew that the taxes due were not being paid.*”

***Discussion:***

Code section 6829, subdivision (d) states:

“Willfully fails to pay or cause to be paid [italics omitted] means the failure was the result of an intentional, conscious, *and* voluntary course of action.” (Emphasis added.)

Pursuant to the definition provided under Code section 6829, three factors must be established in order to find that a person willfully failed. It must be shown the failure was 1) intentional, 2) conscious, *and* 3) voluntary. The use of the word “intentional” in the definition makes it clear the legislature only intended to hold individuals responsible when their action or inaction was carried out with a desired result.

Intentional may be defined as the willingness to bring about something planned or foreseen. (Blacks Law Dict. (8<sup>th</sup> ed. 2004) p. 826, col. 2; also see *Marich v. MGM/UA Telecommunications, Inc.* (2003) 113 Cal.App.4th 415, 421-422 [where the court thoroughly analyzes and defines the meaning of intentional as “those consequences which (a) represent the very purpose for which an act is done (regardless of the likelihood of occurrence), or (b) are known to be substantially certain to result (regardless of desire).”].)

In order to plan or foresee that taxes will not be paid, i.e., intentionally fail to pay, a person must have *knowledge* that their action or inaction will result in the failure to pay. Failure to pay without knowledge or intent would be akin to negligence, which is below the “intentional” threshold established under the law.

The IDP includes language that appears to undermine or conflict with the law. For example, the proposed language accurately states that a person can be held liable if that person “knew...that the taxes were not being paid.” The same sentence, however, includes “or must have known.” The manner in which the sentence is written suggests that “must have known” is something different than “knew.” In other words, it appears to state that something less than knowledge is sufficient to establish that a person willfully failed to pay, e.g., negligence.

The second sentence in the subdivision further conflicts with the legal definition of willful failure by stating that “[e]vidence of actual knowledge is not required.” This is an inaccurate explanation of the law because 1) in order to willfully fail to pay, an individual must do so intentionally, 2) in order to intentionally fail, an individual must have knowledge that their action or inaction will result in a failure to pay, and 3) the burden is on the Board to prove that a personal willfully failed. Thus, evidence of actual knowledge *is* required.

Because the alternative language accurately describes the law and it will help to avoid confusion created by the language presented in the IDP, we believe the alternative language should be presented to the Board Members for adoption.

**Subdivision (b)(2)(C) (sub-element of “willfully fails”)**

Proposed language:

IDP: *“The responsible person had the ability to pay the taxes but chose not to. The Board need not establish that the actual amount of taxes owed was available at any given time. The Board must only establish that funds were, in general, available and not paid to the Board.”*

APL: *“The responsible person had the ability to pay the taxes but chose not to.”*

***Discussion:***

We believe the language proposed in the IDP for subdivision (b)(2)(C) is overly broad and inconsistent with the law. Code section 6829, subdivision (b) states:

“The officer, member, manager, partner, or other person shall be liable only for taxes that ***became due during the period he or she had control....***” (Emphasis added.)

Code section 6829, subdivision (b) establishes a limitation to the period in which an individual may be held personally responsible. Specifically, an individual can only be held responsible for tax that “became due during the period he or she had control.” Therefore, it is the Board’s obligation in administering Code section 6829, to show that the taxes at issue became due *during the period* the person pursued had control. Showing that funds were available “at any given time” or “in general,” may be interpreted to include periods well before or well after the period in which the responsible person had control. Therefore, the language is inconsistent with the law.

The alternative language accurately describes the law. If a person with knowledge has the ability to pay taxes that are due, but chooses not to, that person may be held liable under Code section 6829. The availability of funds “at any given time” or “in general,” however, does not necessarily prove that a responsible person had the ability to pay the taxes that became due during the period in which he or she had control.

Because the alternative language accurately describes circumstances under which personal liability may attach, and the IDP language does not, we believe the alternative language should be presented to the Board Members for approval.

**Subdivision (d), Burden Of Proof**

Proposed language:

IDP: *“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.”*

APL: The APL did not include any proposed language.

***Discussion:***

We agree with Staff’s proposal to clarify the burden and standard of proof under subdivision (d).

**Subdivision (e), Presumption of No Personal Liability:**

Proposed language:

IDP and APL (identical language): “*For a Notice of Determination issued against a responsible person after July 1, 2016, 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.*”

*Discussion*

At the IPM we discussed scenarios in which personal liability is pursued for the failure to pay use tax on materials consumed under construction contracts, and similar circumstances. We believe a circumstance in which an individual fails to pay use tax due on the consumption of goods, is different from a circumstance in which an individual fails to remit tax that was collected. Therefore, we propose an alteration to IDP subdivision (e) to include a favorable presumption and a higher standard of proof when there is a failure to pay use tax on the consumption of goods:

Proposed Alternative:

**(e) PRESUMPTION OF NO PERSONAL LIABILITY** For a Notice of Determination issued against a responsible person after July 1, 2016, if the underlying liability stems from a failure to pay use tax due on the consumption of tangible personal property, or 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.

We thank you for providing us with the opportunity to submit these suggestions. Please feel free to contact me with any questions or comments.

Sincerely,

  
Jesse W. McClellan, Esq.  
Principal