



STATE BOARD OF EQUALIZATION

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Executive Director

October 9, 2015

Dear Interested Party:

Enclosed is the Initial 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, an interested parties meeting is scheduled as follows:

**October 22, 2015
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 by November 6, 2015. 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
Tax and Fee Administration Department

SB:llw

Enclosures

cc: (all with enclosures, via email and/or hardcopy as requested)
Honorable Jerome E. Horton, Chairman, Third District
Senator George Runner (Ret.), Vice Chair, First District
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
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. Jim Kuhl, Board Member's Office, Second District
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
Ms. Lizette Mata, 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
Ms. Lynne Kinst, Board Member's Office, Fourth 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. John Thiella (MIC 73)
Mr. David Levine (MIC 85)
Mr. Bradley Heller (MIC 82)
Mr. Lawrence Mendel (MIC 82)
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)

INITIAL DISCUSSION PAPER

Regulation 1702.5, *Responsible Person Liability*

Issue

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

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.

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. Among other things, Regulation 1702.5 defines the key terms: "responsible person," "willful," and "termination."

BOE Compliance Policy and Procedures Manual (CPPM)

Procedures for identifying and establishing liability in 6829 dual determinations are provided in Compliance Policy and Procedures Manual (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.

INITIAL DISCUSSION PAPER

Regulation 1702.5, *Responsible Person Liability*

Discussion

After review of Regulation 1702.5 and the applicable CPPM sections, staff recommends Regulation 1702.5 be revised to clarify the definitions of “responsible person,” “willful,” and “termination.” Staff further recommends adding information regarding the BOE’s burden of proof to establish responsible person liability. Staff also recommends adding a rebuttable presumption of when there is no personal liability for certain types of persons.

Definition of “Responsible Person”

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, Regulation 1702.5(b)(1).)

Definition of “Willful”

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 evil motive.

CPPM section 764.150 further 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).

INITIAL DISCUSSION PAPER

Regulation 1702.5, *Responsible Person 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.

Again, the full CPPM text is too detailed to include in the regulation. Instead, staff proposes adding the main concepts of these provisions to Regulation 1702.5 (b)(2). For example, staff suggests adding language to explain that having authority does not include the situation where a responsible person was required to obtain approval from another person prior to paying the liabilities at issue and was unable to act on his or her own in making decisions. Staff has also deleted the word “evil” from the phrase, “...was not done with a bad purpose or evil motive;” staff believes the word “bad” is sufficient. (See Exhibit 1.) Staff further recommends revising the title of subdivision (b)(2) to “Willfully Fails to Pay or to Cause to Be Paid” to correspond more closely to the language of RTC section 6829 (d) and Regulation 1702.5 (a).

Definition of “Termination”

To hold a person personally liable, BOE must establish that the entity’s business has been terminated, dissolved, or abandoned. CPPM section 764.120 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. It also explains that there is no requirement that the entity itself ceases to exist or even ceases doing business in some other manner or in some other state. Staff recommends that these statements be added as clarification to Regulation 1702.5 (b)(3).

Burden of Proof

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 recommends that a new subdivision be added to Regulation 1702.5 to explain BOE’s burden of proof (see Exhibit 1, Regulation 1702.5 (d)).

Rebuttable Presumption of No Personal Liability

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

INITIAL DISCUSSION PAPER

Regulation 1702.5, *Responsible Person Liability*

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 that for determinations 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 unless the BOE rebuts the presumption with clear and convincing evidence. (See Exhibit 1, Regulation 1702.5 (e).)

Summary

Staff welcomes any comments, suggestions, or other input on this issue. Staff invites interested parties to participate in the October 22, 2015, interested parties meeting. The deadline to provide written responses regarding this discussion paper is November 6, 2015.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 10/06/2015

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 cause them to be paid, only when the Board establishes all of the following:

(A) 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.

(B) At the time the taxes came due, the responsible person had the authority to pay the taxes or cause them to be paid. A responsible person who was required to obtain approval from another person prior to paying the liabilities at issue and was unable to act on his or her own in making decisions does not have the authority to pay the taxes or cause them to be paid.

(C) 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.

(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. "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.

(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. 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.