



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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**STATE BOARD OF EQUALIZATION**



BOARD APPROVED

At the August 30, 2016 Board Meeting

Joann Richmond  
Joann Richmond, Chief  
Board Proceedings Division

July 15, 2016

**To Interested Parties:**

**Notice of Documents Being Added to the Rulemaking File  
for the State Board of Equalization's Proposed Adoption of  
Amendments to California Code of Regulations,  
Title 18, Section 1702.5, *Responsible Person Liability***

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation or Reg.) 1702.5, *Responsible Person Liability*. The proposed amendments address a current issue with Regulation 1702.5 by providing sufficient clarification and guidance regarding all of the Board's historical legal interpretations of RTC section 6829's and Regulation 1702.5's provisions, ensuring that Board staff's efforts in pursuing personal liability, under RTC section 6829, are more focused on those persons, whom prior experience has shown, are generally found to be personally liable based on the evidence, and only permitting a Notice of Determination (NOD) to be issued to a person for a responsible person liability, under RTC section 6829, after Board staff has evidence to satisfy the regulation's requirements for personal liability against that person.

**PUBLIC HEARING**

The Board will conduct a meeting in Room 121 at 450 N Street, Sacramento, California on August 30-31 and September 1, 2016. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov) at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:00 a.m. or as soon thereafter as the matter may be heard on August 30 or 31 or September 1, 2016. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1702.5.

## **AUTHORITY**

RTC section 7051

## **REFERENCE**

RTC section 6829

## **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

### Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Reg. 1700, *Reimbursement for Sales Tax*.)

When sales tax does not apply, use tax is imposed on the use of tangible personal property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the property is liable for the tax. (RTC, §§ 6201, 6202.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the State Board of Equalization (Board), and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6203, 6204; Reg. 1684, *Collection of Use Tax by Retailers*.)

Every person engaged in the business of selling (or leasing) tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a seller's permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers. (Reg. 1699, *Permits*.) "Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect [use] tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state." (Reg. 1684.)

RTC section 6829 was enacted in 1981 and became effective on January 1, 1982. Currently, RTC section 6829, subdivision (a), provides that "[u]pon the termination, dissolution, or abandonment of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company [(hereafter entity)], 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, or who is under a duty to act for the

[entity] in complying with any requirement of [the Sales and Use Tax Law (RTC, § 6001 et seq.)] [(hereafter responsible person)], shall . . . be personally liable for any unpaid taxes and interest and penalties on those taxes, if the [responsible person] willfully fails to pay or to cause to be paid any taxes due from the [entity].” RTC section 6829, subdivisions (b), limits a responsible person’s liability to “taxes that became due during the period he or she had the control, supervision, responsibility, or duty to act for the” entity, “plus interest and penalties on those taxes.” RTC section 6829, subdivision (c), also requires that the Board establish that the taxes relate to transactions in which the entity “included [sales] tax reimbursement in the selling price of, or added [sales] tax reimbursement to the selling price of, tangible personal property sold in the conduct of its business, or [the entity] consumed tangible personal property and failed to pay the [use] 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 [the] use tax.” RTC section 6829, subdivision (d), defines the phrase “willfully fails to pay or to cause to be paid” to mean “that the failure was the result of an intentional, conscious, and voluntary course of action.” RTC section 6829, subdivisions (e) and (f), respectively require a responsible person’s liability to be collected by a NOD issued under chapter 5 (commencing with RTC § 6451) of the Sales and Use Tax Law and establish the statute of limitations for issuing a timely NOD to a responsible person.

The Board adopted Regulation 1702.5 in 1996 to implement, interpret, and make specific RTC section 6829, including to provide additional guidance regarding when a person can be held personally liable for the unpaid liabilities of an entity, and the regulation became effective on February 8, 1997. As relevant here, subdivision (a) of the regulation provides the general rule for imposing personal liability under RTC section 6829, subdivisions (a) through (c). Subdivision (b) of the regulation defines the terms “responsible person,” “willful,” and “termination” as follows:

- (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 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) Willful. As used herein, the term “willful” means voluntary, conscious and intentional. 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.
- (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.

Subdivision (c) of the regulation also provides the statute of limitations for timely issuing a NOD to a responsible person for an entity’s liabilities.

The Board adopted non-substantive changes to Regulation 1702.5 in September 2008, which became effective on January 2, 2009, to make the regulation consistent with amendments adding “partnership,” “limited partnership,” and “limited liability partnership” to the list of entities in RTC section 6829 and adding the statute of limitations to RTC section 6829, subdivision (f), and the regulation has not been amended or updated since that time.

Effects, Objective, and Benefit of the Proposed Amendments to Regulation 1591

*Need for Clarity and Guidance*

The Board has administered and enforced the provisions of RTC section 6829 for over 30 years and the provisions of Regulation 1702.5 for almost 20 years and, as a result of that experience, the Board and Board staff has obtained specialized knowledge from applying the statute and regulation to varying facts and circumstances. Also, the Board publishes a Compliance Policy and Procedures Manual (CPPM) on its website, which is “an advisory publication providing directions to [Board] staff administering the Sales and Use Tax Law,” and the Board has provided advice to Board staff about the imposition of personal liabilities under RTC section 6829 and Regulation 1702.5 in CPPM sections 764.080-7648.180. Based upon the Board’s and Board staff’s experience and the advice in the CPPM, the Board’s Business Taxes Committee (BTC) staff determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) because Regulation 1702.5 does not provide sufficient clarification and guidance regarding all of the Board’s historical legal interpretations of RTC section 6829’s and Regulation 1702.5’s provisions.

A. Liability of a Responsible Person - Regulation 1702.5, subdivision (a)

For a number of years, the Board’s legal interpretation of RTC section 6829 and Regulation 1702.5 has been that a responsible person is only personally liable for an entity’s liabilities arising from the entity’s taxable sales and uses that occurred while the person was a responsible person. (See, e.g., CPPM section 764.140, *Establishing the Elements of an RTC Section 6829 Dual Determination – Responsible Person* [stating 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”]; and the Petition for Rehearing Summary for Item H1.3., the Petition for Rehearing of David A Bartel, attached to the public agenda notice (on the Board’s website) for the Board’s September 12-13, 2012, meeting [concluding that under Regulation 1702.5, subdivision (a), petitioner cannot be held liable “for the taxes incurred by [the entity at issue] on its sales made prior to December 7, 2007, when petitioner became responsible”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments to Regulation 1702.5, subdivision (a), to clarify that a person shall “only” be personally liable for an entity’s unpaid liabilities if the Board establishes that, while the person was a responsible person, “as defined in in subdivision (b)(1),” the entity made the taxable sales and uses of tangible personal property that gave rise to the liabilities.

B. Definition of “Responsible Person” - Regulation 1702.5, subdivision (b)(1)

Personal liability can only be imposed on a responsible person under RTC section 6829. 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” an entity “in complying with any provision of the Sales and Use Tax Law.” For a number of years, the Board’s legal interpretation of RTC section 6829 and Regulation 1702.5 has been that a person’s title, in and of itself, is not sufficient to establish that the person is a responsible person. (See, e.g., CPPM section 764.140, *Establishing the Elements of an RTC Section 6829 Dual Determination – Responsible Person* [stating that “The fact that a person possesses a title such as corporate officer, partner, or member, in and of itself, is not grounds for holding the person personally liable”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments to the definition of “responsible person,” in Regulation 1702.5, subdivision (b)(1), to clarify 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.’”

C. Definition of “Willful” - Regulation 1702.5, subdivision (b)(2)

Personal liability can only be imposed under RTC section 6829 if a responsible person “willfully fails to pay or to cause to be paid” the taxes due from an entity and RTC section 6829, subdivision (d), expressly defines the phrase “willfully fails to pay or to cause to be paid” to mean “that the failure was the result of an intentional, conscious, and voluntary course of action.” Regulation 1702.5, subdivision (b)(2), currently defines the term “willful” as “voluntary, conscious, and intentional.” It also provides 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.” In order to eliminate any unnecessary confusion that might be caused by the slight differences in terminology used in the statute and regulation, BTC staff drafted amendments to revise the first sentence in Regulation 1702.5, subdivision (b)(2), so that it consistently defines the phrase “willfully fails to pay or cause to be paid” using the same definition provided by RTC section 6829, subdivision (d). BTC staff’s also drafted amendments to delete the unnecessary reference to “evil” motives from the second sentence in subdivision (b)(2).

In addition, for a number of years, the Board’s legal interpretation has been that a responsible person “willfully fails to pay or to cause to be paid” taxes when the responsible person had knowledge that the taxes were not being paid, the responsible person had the authority to pay the taxes or cause them to be paid, and the responsible person had the ability to pay the taxes but chose not to. (See, e.g., the first paragraph in CPPM section 764.150, *Establishing the Elements of an RTC Section 6829 Dual Determination – Willfulness*; and the Board Hearing Summary for Item C7, the Petition for Redetermination of Ricky Alan Dumas, attached to the public agenda notice (on the Board’s website) for the Board’s April 22, 2014, meeting [stating that “A person is regarded as having willfully failed to pay taxes, or to cause them to be paid, where he or she had knowledge that the taxes were not being paid and had the authority to pay taxes or cause them to

be paid, but failed to do so”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding a new third sentence to Regulation 1702.5, subdivision (b)(2), and adding new subdivision (b)(2)(A) through (C), to clarify that a person willfully fails to pay taxes or cause them to be paid, only when the Board establishes that the person “knew” or “must have known” that the taxes were not being paid “[a]t the time the taxes came due,” the person had the authority to pay the taxes or cause them to be paid “[a]t the time the taxes came due,” and the person had the ability to pay the taxes, but chose not to, although “the Board need not establish that the actual amount of taxes owed was available at any given time” and “must only establish that funds were, in general, available.”

D. Definition of Termination - Regulation 1702.5, subdivision (b)(3)

Under RTC section 6829, personal liability for an entity’s liabilities can only be imposed on a person after the termination, dissolution, or abandonment of the business of the entity. Regulation 1702.5, subdivision (b)(3), currently defines “termination” of the business of an entity as including the “discontinuance or cessation of business activities.” And, the Board’s legal interpretation of the phrase “business activities” in the regulation has historically been that the phrase refers to activities for which the entity was required to hold a seller’s permit or certificate of registration for the collection of use tax. (See, e.g., CPPM section 764.120, *Establishing the Elements of an RTC Section 6829 Dual Determination – Termination, Dissolution, or Abandonment* [stating 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”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding two sentences to the definition of “termination” in Regulation 1702.5, subdivision (b)(3), to clarify that there is a “termination” of an entity’s business if there is a discontinuance or cessation of the business activities for which the entity was required to hold a seller’s permit or certificate of registration for the collection of use tax, and that it does not require more.

E. Burden of Proof and Standard of Proof - Regulation 1702.5, subdivision (d)

Regulation 1702.5 does not provide notice regarding the Board’s long-standing position that the Board has the burden of proof to establish by a preponderance of the evidence all of the requirements to impose personal liability on a person for an entity’s liabilities under RTC section 6829. (See, e.g., CPPM section 764.080 [explaining that when “each of [the] elements is not established, then an NOD for personal liability under RTC section 6829 cannot be issued”]; and CPPM sections 764.090, 764.110, which use the term “more likely than not” in the discussion of section 6829.) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding new subdivision (d) to Regulation 1702.5 to provide that the Board has the burden to prove the requirements for personal liability based upon a preponderance of the evidence.

F. Rebuttable Presumption - Regulation 1702.5, subdivision (e)

Over the years, the Board and Board staff have learned what types of evidence is typically obtained to support the elements of personal liability under RTC section 6829 and the strength of these types of evidence. In addition, the Board and Board staff have learned what types of persons are generally not personally liable. Based on this knowledge and experience, Board staff recommended 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 recommended adding subdivision (e) to Regulation 1702.5 to include a rebuttable presumption that provides that if the person is not an "officer, member, partner or a manager with an ownership interest in the entity," the person is presumed to not be personally liable, unless the Board rebuts the presumption with clear and convincing evidence.

*Interested Parties Process*

BTC staff prepared a discussion paper explaining the draft amendments to Regulation 1702.5. BTC staff provided the discussion paper and draft amendments to the interested parties, and on October 22, 2015, BTC staff conducted an interested parties meeting to discuss the draft amendments.

During and after the interested parties meeting, interested parties expressed some confusion about and did not entirely support the draft language staff included in new subdivision (b)(2)(A) through (C). Based on all input and comments, staff revised the new subdivision to further clarify and explain that a person willfully fails to pay taxes or cause them to be paid, only when the Board establishes that the person had "knowledge" that the taxes were due but not being paid "[o]n or after the date that the taxes came due," and the person had the authority to pay the taxes or cause them to be paid "[o]n the date the taxes came due." Staff also deleted the provisions permitting the Board to establish that a person had the ability to pay taxes by establishing that funds were available at some time or "in general."

Also, following the interested parties meeting, interested parties suggested expanding the rebuttable presumption in new subdivision (e) to apply if the underlying liability stems from a failure to pay use tax due on the consumption of tangible personal property. However, staff concluded that RTC section 6829 generally applies to entities' use tax liabilities, so staff did not add a presumption regarding use tax liabilities.

BTC staff prepared a second discussion paper explaining the revised draft amendments to Regulation 1702.5. BTC staff provided the discussion paper and revised draft amendments to the interested parties, and on January 7, 2016, BTC staff conducted a second interested parties meeting to discuss the second discussion paper and the revised draft amendments. Staff received one written comment prior to the interested parties meeting in a December 30, 2015, letter from Ms. Patricia Verdugo of Bewley Lassleben & Miller LLP. After the second interested parties meeting, staff also received a letter dated January 21, 2016, from Mr. Jesse McClellan of McClellan Davis, LLC.

In her letter, Ms. Verdugo recommended that the new sentence being added to subdivision (b)(1) be revised to refer to “all titles listed in the first sentence” of the subdivision since staff had omitted references to “manager,” “employee,” “director,” and “shareholder.” Ms. Verdugo recommended that new subdivision (b)(2)(A) through (C) be clarified to require “actual” knowledge that taxes were due and not being paid, and that both paragraphs (A) and (B) start with the phrase “On the date that the taxes came due” to be consistent. Ms. Verdugo recommended that subdivision (d) require the Board to prove that the requirements for personal liability have been satisfied by “clear and convincing evidence.” Ms. Verdugo indicated that she thought the presumption being added to new subdivision (e) needed clarification and should be revised and reformatted as two presumptions, one presumption that applies to “a person” that “does not have an ownership interest in the entity,” regardless of the person’s title, and another presumption that applies to a person with an ownership interest that is not also an “officer, member, partner, or manager of the entity.”

In his letter, Mr. McClellan supported Ms. Verdugo’s recommendation to replace the “preponderance of the evidence” standard with a “clear and convincing evidence” standard in new subdivision (d). Mr. McClellan also recommended revising staff’s amendments to the definition of “termination” in subdivision (b)(3) to clarify that termination does not occur when the entity “continues the business activities for which it was required to hold a seller’s permit or certificate of registration for the collection of use tax, under a separate permit or registration.”

Staff agreed with Ms. Verdugo that the sentence being added to subdivision (b)(1) should apply to all of the listed titles and revised the sentence to provide that “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.’” Staff agreed with Ms. Verdugo that new subdivision (b)(1)(A) should be clarified to require “actual” knowledge that taxes were due and not being paid and added the word “actual” to the subdivision.

Based upon all input and comments, staff determined that new subdivision (b)(2)(B) and (C) was still somewhat unclear. Therefore, staff revised subdivision (b)(2)(B) to clarify that the Board must establish that 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,” that they were due, but not being paid; and revised subdivision (b)(2)(C) to clarify that the Board must establish that “[w]hen the responsible person had actual knowledge” that the taxes were due, but not being paid, “the responsible person had the ability to pay the taxes but chose not to do so.” Based upon all input and comments, staff also revised the definition of termination to clarify that termination refers to 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.”

Staff did not agree with the comments received that the standard of proof should be “clear and convincing evidence” in new subdivision (d) and staff did not change its draft subdivision (d). Also, staff determined that the rebuttable presumption in new subdivision (e) was properly



focused and only made minor grammatical changes to the wording of the presumption to clarify that the phrase “with an ownership interest in the entity” only modifies the subdivision’s reference to “manager.”

In addition, based on the interested parties’ input and comments, staff determined that it was necessary to emphasize, in the regulation, that an NOD should only be issued to a person for a responsible person liability, once Board staff has established that the regulation’s requirements for personal liability against that person have been satisfied. Therefore, staff also added language to that effect to the beginning of the text of current subdivision (c)(1).

*March 30, 2016, Business Taxes Committee Meeting*

Subsequently, staff prepared Formal Issue Paper 16-01 and distributed it to the Board Members, along with BTC staff’s revised draft amendments to Regulation 1702.5 (discussed above), for consideration at the Board’s March 30, 2016, BTC meeting. The formal issue paper explained and recommended that the Board propose to adopt staff’s revised draft amendments to Regulation 1702.5.

At the conclusion of the Board’s discussion of Formal Issue Paper 16-01 during the March 30, 2016, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1702.5 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1702.5 are reasonably necessary to have the effect and accomplish the objective of addressing the issue (or problem) with Regulation 1702.5 (discussed above) by providing sufficient clarification and guidance regarding all of the Board’s historical legal interpretations of RTC section 6829’s and Regulation 1702.5’s provisions, ensuring that Board staff’s efforts in pursuing personal liability, under RTC section 6829, are more focused on those persons, whom prior experience has shown, are generally found to be personally liable based on the evidence, and only permitting an NOD to be issued to a person for a responsible person liability after Board staff has evidence to satisfy the regulation’s requirements for personal liability against that person. The Board anticipates that the proposed amendments to Regulation 1702.5 will promote fairness and benefit potential responsible persons, Board staff, and the Board by providing updated guidance on how and when personal liability may be imposed on a responsible person.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1702.5 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that implement, interpret, and make specific RTC section 6829. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1702.5 or the proposed amendments to Regulation 1702.5.

### **NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that the adoption of the proposed amendments to Regulation 1702.5 will not impose a mandate on local agencies or school districts, including a mandate that requires state reimbursement under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

### **NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT**

The Board has determined that the adoption of the proposed amendments to Regulation 1702.5 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

### **NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1702.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1702.5 may affect small business.

### **NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

### **RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the proposed amendments to Regulation 1702.5 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1702.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create new businesses or expand businesses currently doing business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1702.5 will not affect

the benefits of Regulation 1702.5 to the health and welfare of California residents, worker safety, or the state's environment.

### **NO SIGNIFICANT EFFECT ON HOUSING COSTS**

The adoption of the proposed amendments to Regulation 1702.5 will not have a significant effect on housing costs.

### **DETERMINATION REGARDING ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

### **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Christine Bisauta Castillo, Tax Counsel III (Supervisor), by telephone at (916) 323-2549, by e-mail at [Christine.Bisauta@boe.ca.gov](mailto:Christine.Bisauta@boe.ca.gov), or by mail at State Board of Equalization, Attn: Christine Bisauta Castillo, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080. Mr. Bennion is the designated backup contact person to Ms. Castillo.

### **WRITTEN COMMENT PERIOD**

The written comment period ends at 9:00 a.m. on August 30 or 31 or September 1, 2016, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1702.5 during the August 30-31, and September 1, 2016, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1702.5. The Board will only consider written comments received by that time.

**AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an underscored and strikethrough version of the text of Regulation 1702.5 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1702.5, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).


**SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt the proposed amendments to Regulation 1702.5 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

**AVAILABILITY OF FINAL STATEMENT OF REASONS**

If the Board adopts the proposed amendments to Regulation 1702.5, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

Sincerely,

  
Joann Richmond, Chief  
Board Proceedings Division

JR:reb

**Initial Statement of Reasons for  
Proposed Amendments to California Code of Regulations,  
Title 18, Section 1702.5, *Responsible Person Liability***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFITS

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code (RTC), § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § (Regulation or Reg.) 1700, *Reimbursement for Sales Tax*.)

When sales tax does not apply, use tax is imposed on the use of tangible personal property purchased from a retailer for storage, use, or other consumption in California. (RTC, §§ 6201, 6401.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the property is liable for the tax. (RTC, §§ 6201, 6202.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the State Board of Equalization (Board), and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, §§ 6203, 6204; Reg. 1684, *Collection of Use Tax by Retailers*.)

Every person engaged in the business of selling (or leasing) tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and only a person actively so engaged, is required to hold a seller's permit for each place of business in this state at which transactions relating to sales are customarily negotiated with his or her customers. (Reg. 1699, *Permits*.) "Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect [use] tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state." (Reg. 1684.)

RTC section 6829 was enacted in 1981 and became effective on January 1, 1982. Currently, RTC section 6829, subdivision (a), provides that "[u]pon the termination, dissolution, or abandonment of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company [(hereafter entity)], 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, or who is under a duty to act for the [entity] in complying with any requirement of [the Sales and Use Tax Law (RTC, § 6001 et seq.)] [(hereafter responsible person)], shall . . . be personally liable for any unpaid taxes and

interest and penalties on those taxes, if the [responsible person] willfully fails to pay or to cause to be paid any taxes due from the [entity].” RTC section 6829, subdivisions (b), limits a responsible person’s liability to “taxes that became due during the period he or she had the control, supervision, responsibility, or duty to act for the” entity, “plus interest and penalties on those taxes.” RTC section 6829, subdivision (c), also requires that the Board establish that the taxes relate to transactions in which the entity “included [sales] tax reimbursement in the selling price of, or added [sales] tax reimbursement to the selling price of, tangible personal property sold in the conduct of its business, or [the entity] consumed tangible personal property and failed to pay the [use] 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 [the] use tax.” RTC section 6829, subdivision (d), defines the phrase “willfully fails to pay or to cause to be paid” to mean “that the failure was the result of an intentional, conscious, and voluntary course of action.” RTC section 6829, subdivisions (e) and (f), respectively require a responsible person’s liability to be collected by a Notice of Determination (NOD) issued under chapter 5 (commencing with RTC § 6451) of the Sales and Use Tax Law and establish the statute of limitations for issuing a timely NOD to a responsible person.

The Board adopted Regulation 1702.5, *Responsible Person Liability*, in 1996 to implement, interpret, and make specific RTC section 6829, including to provide additional guidance regarding when a person can be held personally liable for the unpaid liabilities of an entity, and the regulation became effective on February 8, 1997. As relevant here, subdivision (a) of the regulation provides the general rule for imposing personal liability under RTC section 6829, subdivisions (a) through (c). Subdivision (b) of the regulation defines the terms “responsible person,” “willful,” and “termination” as follows:

- (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 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) Willful. As used herein, the term “willful” means voluntary, conscious and intentional. 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.
- (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.

Subdivision (c) of the regulation also provides the statute of limitations for timely issuing a NOD to a responsible person for an entity’s liabilities.

The Board adopted non-substantive changes to Regulation 1702.5 in September 2008, which became effective on January 2, 2009, to make the regulation consistent with amendments adding

“partnership,” “limited partnership,” and “limited liability partnership” to the list of entities in RTC section 6829 and adding the statute of limitations to RTC section 6829, subdivision (f), and the regulation has not been amended or updated since that time.

## Proposed Amendments

### *Need for Clarity and Guidance*

The Board has administered and enforced the provisions of RTC section 6829 for over 30 years and the provisions of Regulation 1702.5 for almost 20 years and, as a result of that experience, the Board and Board staff has obtained specialized knowledge from applying the statute and regulation to varying facts and circumstances. Also, the Board publishes a Compliance Policy and Procedures Manual (CPPM) on its website, which is “an advisory publication providing directions to [Board] staff administering the Sales and Use Tax Law,”<sup>1</sup> and the Board has provided advice to Board staff about the imposition of personal liabilities under RTC section 6829 and Regulation 1702.5 in CPPM sections 764.080-7648.180.<sup>2</sup> Based upon the Board’s and Board staff’s experience and the advice in the CPPM, the Board’s Business Taxes Committee (BTC) staff determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) because Regulation 1702.5 does not provide sufficient clarification and guidance regarding all of the Board’s historical legal interpretations of RTC section 6829’s and Regulation 1702.5’s provisions.

#### A. Liability of a Responsible Person - Regulation 1702.5, subdivision (a)

For a number of years, the Board’s legal interpretation of RTC section 6829 and Regulation 1702.5 has been that a responsible person is only personally liable for an entity’s liabilities arising from the entity’s taxable sales and uses that occurred while the person was a responsible person. (See, e.g., CPPM section 764.140, *Establishing the Elements of an RTC Section 6829 Dual Determination – Responsible Person* [stating 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”]; and the Petition for Rehearing Summary for Item H1.3., the Petition for Rehearing of David A Bartel, attached to the public agenda notice (on the Board’s website) for the Board’s September 12-13, 2012, meeting [concluding that under Regulation 1702.5, subdivision (a), petitioner cannot be held liable “for the taxes incurred by [the entity at issue] on its sales made prior to December 7, 2007, when petitioner became responsible”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments to Regulation 1702.5, subdivision (a), to clarify that a person shall “only” be personally liable for an entity’s unpaid liabilities if the Board establishes that, while the person was a responsible person, “as defined in in subdivision (b)(1),” the entity made the taxable sales and uses of tangible personal property that gave rise to the liabilities.

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<sup>1</sup> The purpose of the CPPM is explained as follows: “The information in this manual will assist compliance staff in the equitable and uniform administration of the business tax programs administered by the [Board]. The manual incorporates processes, procedures, and techniques that have evolved over a period of years and that have proven to be effective.” (CPPM section 105.005.)

<sup>2</sup> After being posted for public comment, the current text of CPPM sections 764.080-764.180 was approved by the Board at the March 24, 2014, Board Meeting.

## B. Definition of “Responsible Person” - Regulation 1702.5, subdivision (b)(1)

Personal liability can only be imposed on a responsible person under RTC section 6829. 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” an entity “in complying with any provision of the Sales and Use Tax Law.” For a number of years, the Board’s legal interpretation of RTC section 6829 and Regulation 1702.5 has been that a person’s title, in and of itself, is not sufficient to establish that the person is a responsible person. (See, e.g., CPPM section 764.140, *Establishing the Elements of an RTC Section 6829 Dual Determination – Responsible Person* [stating that “The fact that a person possesses a title such as corporate officer, partner, or member, in and of itself, is not grounds for holding the person personally liable”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments to the definition of “responsible person,” in Regulation 1702.5, subdivision (b)(1), to clarify 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.’”

## C. Definition of “Willful” - Regulation 1702.5, subdivision (b)(2)

Personal liability can only be imposed under RTC section 6829 if a responsible person “willfully fails to pay or to cause to be paid” the taxes due from an entity and RTC section 6829, subdivision (d), expressly defines the phrase “willfully fails to pay or to cause to be paid” to mean “that the failure was the result of an intentional, conscious, and voluntary course of action.” Regulation 1702.5, subdivision (b)(2), currently defines the term “willful” as “voluntary, conscious, and intentional.” It also provides 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.” In order to eliminate any unnecessary confusion that might be caused by the slight differences in terminology used in the statute and regulation, BTC staff drafted amendments to revise the first sentence in Regulation 1702.5, subdivision (b)(2), so that it consistently defines the phrase “willfully fails to pay or cause to be paid” using the same definition provided by RTC section 6829, subdivision (d). BTC staff’s also drafted amendments to delete the unnecessary reference to “evil” motives from the second sentence in subdivision (b)(2).

In addition, for a number of years, the Board’s legal interpretation has been that a responsible person “willfully fails to pay or to cause to be paid” taxes when the responsible person had knowledge that the taxes were not being paid, the responsible person had the authority to pay the taxes or cause them to be paid, and the responsible person had the ability to pay the taxes but chose not to. (See, e.g., the first paragraph in CPPM section 764.150, *Establishing the Elements of an RTC Section 6829 Dual Determination – Willfulness*; and the Board Hearing Summary for Item C7, the Petition for Redetermination of Ricky Alan Dumas, attached to the public agenda notice (on the Board’s website) for the Board’s April 22, 2014, meeting [stating that “A person is regarded as having willfully failed to pay taxes, or to cause them to be paid, where he or she had knowledge that the taxes were not being paid and had the authority to pay taxes or cause them to be paid, but failed to do so”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding a new third sentence to Regulation 1702.5, subdivision



(b)(2), and adding new subdivision (b)(2)(A) through (C), to clarify that a person willfully fails to pay taxes or cause them to be paid, only when the Board establishes that the person “knew” or “must have known” that the taxes were not being paid “[a]t the time the taxes came due,” the person had the authority to pay the taxes or cause them to be paid “[a]t the time the taxes came due,” and the person had the ability to pay the taxes, but chose not to, although “the Board need not establish that the actual amount of taxes owed was available at any given time” and “must only establish that funds were, in general, available.”

#### D. Definition of Termination - Regulation 1702.5, subdivision (b)(3)

Under RTC section 6829, personal liability for an entity’s liabilities can only be imposed on a person after the termination, dissolution, or abandonment of the business of the entity. Regulation 1702.5, subdivision (b)(3), currently defines “termination” of the business of an entity as including the “discontinuance or cessation of business activities.” And, the Board’s legal interpretation of the phrase “business activities” in the regulation has historically been that the phrase refers to activities for which the entity was required to hold a seller’s permit or certificate of registration for the collection of use tax. (See, e.g., CPPM section 764.120, *Establishing the Elements of an RTC Section 6829 Dual Determination – Termination, Dissolution, or Abandonment* [stating 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”].) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding two sentences to the definition of “termination” in Regulation 1702.5, subdivision (b)(3), to clarify that there is a “termination” of an entity’s business if there is a discontinuance or cessation of the business activities for which the entity was required to hold a seller’s permit or certificate of registration for the collection of use tax, and that it does not require more.

#### E. Burden of Proof and Standard of Proof - Regulation 1702.5, subdivision (d)

Regulation 1702.5 does not provide notice regarding the Board’s long-standing position that the Board has the burden of proof to establish by a preponderance of the evidence all of the requirements to impose personal liability on a person for an entity’s liabilities under RTC section 6829. (See, e.g., CPPM section 764.080 [explaining that when “each of [the] elements is not established, then an NOD for personal liability under RTC section 6829 cannot be issued”]; and CPPM sections 764.090, 764.110, which use the term “more likely than not” in the discussion of section 6829.) In order to provide clarification and guidance regarding this point, BTC staff drafted amendments adding new subdivision (d) to Regulation 1702.5 to provide that the Board has the burden to prove the requirements for personal liability based upon a preponderance of the evidence.

#### F. Rebuttable Presumption - Regulation 1702.5, subdivision (e)

Over the years, the Board and Board staff have learned what types of evidence is typically obtained to support the elements of personal liability under RTC section 6829 and the strength of these types of evidence. In addition, the Board and Board staff have learned what types of persons are generally not personally liable. Based on this knowledge and experience, Board staff recommended 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 recommended adding subdivision (e) to Regulation 1702.5 to include a rebuttable presumption that provides that if the person is not an “officer, member, partner or a manager with an ownership interest in the entity,” the person is presumed to not be personally liable, unless the Board rebuts the presumption with clear and convincing evidence.

### *Interested Parties Process*

BTC staff prepared a discussion paper explaining the draft amendments to Regulation 1702.5. BTC staff provided the discussion paper and draft amendments to the interested parties, and on October 22, 2015, BTC staff conducted an interested parties meeting to discuss the draft amendments.

During and after the interested parties meeting, interested parties expressed some confusion about and did not entirely support the draft language staff included in new subdivision (b)(2)(A) through (C). Based on all input and comments, staff revised the new subdivision to further clarify and explain that a person willfully fails to pay taxes or cause them to be paid, only when the Board establishes that the person had “knowledge” that the taxes were due but not being paid “[o]n or after the date that the taxes came due,” and the person had the authority to pay the taxes or cause them to be paid “[o]n the date the taxes came due.” Staff also deleted the provisions permitting the Board to establish that a person had the ability to pay taxes by establishing that funds were available at some time or “in general.”

Also, following the interested parties meeting, interested parties suggested expanding the rebuttable presumption in new subdivision (e) to apply if the underlying liability stems from a failure to pay use tax due on the consumption of tangible personal property. However, staff concluded that RTC section 6829 generally applies to entities’ use tax liabilities, so staff did not add a presumption regarding use tax liabilities.

BTC staff prepared a second discussion paper explaining the revised draft amendments to Regulation 1702.5. BTC staff provided the discussion paper and revised draft amendments to the interested parties, and on January 7, 2016, BTC staff conducted a second interested parties meeting to discuss the second discussion paper and the revised draft amendments. Staff received one written comment prior to the interested parties meeting in a December 30, 2015, letter from Ms. Patricia Verdugo of Bewley Lassleben & Miller LLP. After the second interested parties meeting, staff also received a letter dated January 21, 2016, from Mr. Jesse McClellan of McClellan Davis, LLC.

In her letter, Ms. Verdugo recommended that the new sentence being added to subdivision (b)(1) be revised to refer to “all titles listed in the first sentence” of the subdivision since staff had omitted references to “manager,” “employee,” “director,” and “shareholder.” Ms. Verdugo recommended that new subdivision (b)(2)(A) through (C) be clarified to require “actual” knowledge that taxes were due and not being paid, and that both paragraphs (A) and (B) start with the phrase “On the date that the taxes came due” to be consistent. Ms. Verdugo recommended that subdivision (d) require the Board to prove that the requirements for personal liability have been satisfied by “clear and convincing evidence.” Ms. Verdugo indicated that she

thought the presumption being added to new subdivision (e) needed clarification and should be revised and reformatted as two presumptions, one presumption that applies to “a person” that “does not have an ownership interest in the entity,” regardless of the person’s title, and another presumption that applies to a person with an ownership interest that is not also an “officer, member, partner, or manager of the entity.”

In his letter, Mr. McClellan supported Ms. Verdugo’s recommendation to replace the “preponderance of the evidence” standard with a “clear and convincing evidence” standard in new subdivision (d). Mr. McClellan also recommended revising staff’s amendments to the definition of “termination” in subdivision (b)(3) to clarify that termination does not occur when the entity “continues the business activities for which it was required to hold a seller’s permit or certificate of registration for the collection of use tax, under a separate permit or registration.”

Staff agreed with Ms. Verdugo that the sentence being added to subdivision (b)(1) should apply to all of the listed titles and revised the sentence to provide that “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.’” Staff agreed with Ms. Verdugo that new subdivision (b)(1)(A) should be clarified to require “actual” knowledge that taxes were due and not being paid and added the word “actual” to the subdivision.

Based upon all input and comments, staff determined that new subdivision (b)(2)(B) and (C) was still somewhat unclear. Therefore, staff revised subdivision (b)(2)(B) to clarify that the Board must establish that 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,” that they were due, but not being paid; and revised subdivision (b)(2)(C) to clarify that the Board must establish that “[w]hen the responsible person had actual knowledge” that the taxes were due, but not being paid, “the responsible person had the ability to pay the taxes but chose not to do so.” Based upon all input and comments, staff also revised the definition of termination to clarify that termination refers to 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.”

Staff did not agree with the comments received that the standard of proof should be “clear and convincing evidence” in new subdivision (d) and staff did not change its draft subdivision (d). Also, staff determined that the rebuttable presumption in new subdivision (e) was properly focused and only made minor grammatical changes to the wording of the presumption to clarify that the phrase “with an ownership interest in the entity” only modifies the subdivision’s reference to “manager.”

In addition, based on the interested parties’ input and comments, staff determined that it was necessary to emphasize, in the regulation, that an NOD should only be issued to a person for a responsible person liability, once Board staff has established that the regulation’s requirements for personal liability against that person have been satisfied. Therefore, staff also added language to that effect to the beginning of the text of current subdivision (c)(1).

*March 30, 2016, Business Taxes Committee Meeting*

Subsequently, staff prepared Formal Issue Paper 16-01 and distributed it to the Board Members, along with BTC staff's revised draft amendments to Regulation 1702.5 (discussed above), for consideration at the Board's March 30, 2016, BTC meeting. The formal issue paper explained and recommended that the Board propose to adopt staff's revised draft amendments to Regulation 1702.5.

At the conclusion of the Board's discussion of Formal Issue Paper 16-01 during the March 30, 2016, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1702.5 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1702.5 are reasonably necessary for the specific purpose of addressing the issue (or problem) with Regulation 1702.5 (discussed above) by providing sufficient clarification and guidance regarding all of the Board's historical legal interpretations of RTC section 6829's and Regulation 1702.5's provisions, ensuring that Board staff's efforts in pursuing personal liability, under RTC section 6829, are more focused on those persons, whom prior experience has shown, are generally found to be personally liable based on the evidence, and only permitting an NOD to be issued to a person for a responsible person liability after Board staff has evidence to satisfy the regulation's requirements for personal liability against that person. The Board anticipates that the proposed amendments to Regulation 1702.5 will promote fairness and benefit potential responsible persons, Board staff, and the Board by providing updated guidance on how and when personal liability may be imposed on a responsible person.

The proposed amendments to Regulation 1702.5 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1702.5 or the proposed amendments to Regulation 1702.5.

#### DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 16-01, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its March 30, 2016, BTC meeting in deciding to propose the amendments to Regulation 1702.5 described above.

#### ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1702.5 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1702.5 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1702.5 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost

effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

**INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,  
SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY  
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

As discussed in more detailed above, the proposed amendments address a current issue (or problem) with Regulation 1702.5 by providing sufficient clarification and guidance regarding all of the Board's historical legal interpretations of RTC section 6829's and Regulation 1702.5's provisions, ensuring that Board staff's efforts in pursuing personal liability, under RTC section 6829, are more focused on those persons, whom prior experience has shown, are generally found to be personally liable based on the evidence, and only permitting an NOD to be issued to a person for a responsible person liability after Board staff has evidence to satisfy the regulation's requirements for personal liability against that person.

The proposed amendments do not materially change the Board's historical legal interpretations of RTC section 6829's and Regulation 1702.5's provisions (discussed above), and will not materially change the manner in which the Board currently administers the provisions of the statute and regulation. The proposed amendments do not mandate that individuals or businesses do anything that is not already required by the Sales and Use Tax Law (RTC, § 6001 et seq.) or Regulation 1702.5, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action. And, the Research and Statistics Section of the Board's Legislative and Research Division determined that there is nothing in the proposed amendments that would impact revenue. (See Exhibit 1 to Formal Issue Paper 16-01.) Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and businesses. And, the Board has determined that the proposed amendments to Regulation 1702.5 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1702.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create new businesses or expand businesses currently doing business in the State of California.

Furthermore, Regulation 1702.5 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1702.5 will not affect the benefits of Regulation 1702.5 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1702.5 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1702.5 may affect small businesses.

**Text of Proposed Amendments to  
California Code of Regulations, Title 18, Section 1702.5**

**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), 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.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Section 6829, Revenue and Taxation Code.

## Regulation History

**Type of Regulation:** Sales and Use Tax

Regulation: 1702.5

Title: *Responsible Person Liability*

**Preparation:** Christine Bisauta Castillo

**Legal Contact:** Christine Bisauta Castillo

The State Board of Equalization proposes to clarify and provide guidance regarding the Board's historical interpretations of Revenue and Taxation Code section 6829 and the regulation.

### History of Proposed Regulation:

August 30- September 1, 2016	Public Hearing
July 15, 2016	OAL publication date; 45-day public comment period begins; Interested Parties mailing
July 5, 2016	Notice to OAL
March 30, 2016	Business Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION  
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State Controller

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Executive Director

August 5, 2016

To Interested Parties:

**Notice of Proposed Regulatory Action**  
**The State Board of Equalization Proposes to Adopt**  
**Amendments to California Code of Regulations,**  
**Title 18,**  
**Section 1702.5, *Responsible Person Liability***


**NOTICE OF CORRECTION**

The State Board of Equalization (Board) published a Notice of Proposed Regulatory Action (NOPRA) concerning proposed amendments to California Code of Regulations, title 18, section (Regulation) 1702.5, *Responsible Person Liability*, in the July 15, 2016, edition of the California Regulatory Notice Register (Register 2016, No. 29-Z, Page 1200).

On page 1202 of the published NOPRA, the Informative Digest/Policy Statement Overview has the subheading of “Effects, Objective, and Benefit of the Proposed Amendments to Regulation 1591,” although the NOPRA is for amendments to Regulation 1702.5 that have one effect. Therefore, this subheading should have correctly referred to the “Effect, Objective, and Benefit of the Proposed Amendments to Regulation 1702.5,” not Regulation 1591.

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,

  
Joann Richmond, Chief  
Board Proceedings Division

JR:reb