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January 21, 2016

Ms. Susanne Buehler, Chief
Board of Equalization
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092 VIA: Email: Susanne.Beuhler@boe.ca.gov

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

Dear Ms. Buehler,

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

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

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[1] All references to Regulations hereafter are to California Code of Regulations, title 18, unless otherwise noted.
[2] All references to Code sections hereafter are to Revenue and Taxation Code sections unless otherwise noted.

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

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

> "Upon the termination, dissolution, or abandonment of **the business of** a corporation, partnership, limited partnership, limited liability partnership or limited liability company…" (Bolding added)

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

> As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of business activities. <u>"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.</u>

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

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

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

> As used herein, "termination" of the business of a corporation, partnership, limited partnership, limited liability partnership, or limited liability company includes discontinuance or cessation of business activities. "Business Activities" means the activities for which the entity was required to hold a seller's permit or certification of registration for the collection of use tax. There is no requirement that the entity itself cease to exist or even cease doing business in some other manner or in some other state.
>
> Termination does not occur when the corporation, partnership, limited partnership, limited liability partnership, or limited liability

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

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

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

Subdivision (e), currently provides:

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

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

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

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

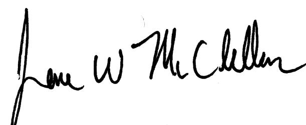
which would clearly preclude the Board of Equalization from applying a heightened standard of proof to personal liability cases through its administrative rule making authority. As stated in *Wallace Berrie & Co. v. State Board of* Equalization (1985) 40 Cal.3d 60, 65, when reviewing the validity of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

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

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

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

Sincerely,



Jesse W. McClellan, Esq.
Principal