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2020 – OTA – 121
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. ACOSTA, TRANSFEREE OF SOFTWARE DREAMER LLC**	) OTA Case No. 18011097

OPINION

Representing the Parties:

For Appellant: Brad Birchfield, Legal Intern
Tax Appeals Assistance Program

For Respondent: Bradley W. Kragel, Tax Counsel III

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Acosta (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing that he is liable, as transferee, for additional taxes, penalties, fees and interest due from Software Dreamer LLC (SD-LLC) for its 2008 through 2013 tax years.

Appellant waived his right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

Whether appellant is liable as transferee for the unpaid taxes, penalties, fees, and interest of SD-LLC.

FACTUAL FINDINGS

1. SD-LLC was a single-member California limited liability company (LLC) formed on behalf of appellant by Bizfilings on September 2, 2008. SD-LLC was classified as a disregarded entity for federal and California income tax purposes. Appellant was SD-LLC's sole member and officer at all times relevant hereto.
2. SD-LLC was in the internet commerce business; it sold software. Appellant devoted his energies on a full-time basis to SD-LLC's business during the years at issue.

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3. Although SD-LLC commenced business in California in September 2008, it failed to timely file California tax returns for the years at issue (2008 through 2013). Eventually, FTB contacted SD-LLC and demanded that it file returns. SD-LLC filed returns (Forms 568, Limited Liability Company Returns of Income) for the years at issue in August/September 2014.
4. SD-LLC's 2009 California return is in the record. On that return, SD-LLC reported "total income from all sources derived from or attributable to California" (i.e., income used for purposes of determining the amount of the LLC fee due under R&TC section 17942) of $356,285, and California cost of goods sold of $267,410. The return also reported that SD-LLC's sole owner's (i.e., appellant's) share of income from SD-LLC was $18,474, and that this amount was distributed to appellant. SD-LLC reported owing a $900 LLC fee and an $800 LLC tax for 2009. However, SD-LLC did not pay either of these amounts to FTB. As a result, FTB imposed various penalties, interest, and fees against SD-LLC, bringing the total amount due from SD-LLC for 2009 to $2,764.53 as of May 8, 2017.
5. Appellant's individual federal income tax return (IRS Form 1040) for 2009 is in the record. On that return, appellant reported he earned total income of $18,474 in 2009, all from SD-LLC. This income was reported as Schedule C income, and appellant reported and paid $2,610 of self-employment tax on this income.
6. Although the record does not contain SD-LLC's or appellant's returns for the other years at issue, FTB's allegations suggest (and we assume) that they are comparable in all respects to the ones we have for 2009. FTB indicates that for each of the years at issue SD-LLC reported that it was liable for a $900 LLC fee and an $800 LLC tax, and that SD-LLC earned relatively small amounts of net income (averaging less than $20,000 per year), and those amounts were distributed each year to appellant. We assume that for each of the years at issue appellant included the income he received from SD-LLC in his income, and that he reported owing both income and self-employment tax on his income from SD-LLC, just as he did for 2009.
7. Appellant filed for bankruptcy protection under Chapter 7 of the Bankruptcy Code on July 1, 2009. In his bankruptcy filings, appellant stated that he owned all of SD-LLC,

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that he was "self-employed" by SD-LLC, and that he earned approximately $2,000 of income per month.

8. On September 2, 2014, SD-LLC filed a Certificate of Cancellation with the California Secretary of State.
9. From October 17, 2014, through November 21, 2015, FTB issued numerous notices and demands for payment to SD-LLC in its unsuccessful attempt to collect the amount owed.
10. On January 25, 2017, FTB issued Notices of Proposed Assessment (NPAs) to appellant, determining that he was liable, as transferee from SD-LLC, for the taxes, penalties, fees and interest that had been assessed against SD-LLC for its tax years 2008 through 2013. The total amount alleged to be due from appellant as transferee was $13,189 as of the date of FTB's NPAs.

DISCUSSION

In California, one's status as a member or manager of an LLC does not, in and of itself, cause one to be liable for the LLC's debts. (See Corp. Code, § 17703.04(a)(2) & (b); see also its predecessors, former Corp. Code, §§ 17101, 17158.) In fact, the general rule in California is that members of an LLC are not liable for the debts, obligations, or other liabilities of the LLC.[1] (*CB Richard Ellis, Inc. v. Terra Nostra Consultants, et al.* (2014) 230 Cal.App.4th 405.)

In this appeal, FTB contends that appellant is "secondarily liable" as "transferee" for the taxes (including penalties, fees, and interest) due from his single-member LLC, SD-LLC, pursuant to R&TC sections 19071 through 19074. The transferee liability procedures set forth in those provisions (in particular, R&TC section 19073) are, in pertinent part, substantially similar to those found in Internal Revenue Code (IRC) section 6901. Accordingly, federal authorities interpreting IRC section 6901 are relevant and persuasive in interpreting and applying R&TC section 19073. (See generally *Meanley v. McColgan* (1942) 49 Cal.App.2d 203, 209 [interpretations of similar federal tax statute are instructive in state statute analysis].)

Under both California and federal law, the secondary liability of a transferee does not involve the imposition of a new tax liability. Rather, it is a means to enforce an existing liability

[1] FTB does not contend otherwise. FTB also does not contend that appellant is liable for SD-LLC's taxes on an alter ego theory of liability, or that appellant received assets upon the dissolution of SD-LLC, which would potentially generate liability under Corporations Code section 17707.07(a)(1)(B).

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against a person that is a transferee of a taxpayer. (*Commissioner v. Stern* (1958) 357 U.S. 39 (*Stern*); IRC, § 6901.)

In determining the liability of a transferee for the tax obligations owed by a transferor, one applies the law of the state where the transfer occurred. (*Stern*, *supra*, 357 U.S. at pp. 44-45; *Adams v. Commissioner* (1978) 70 T.C. 373, 389, affd. without published opinion (2d Cir. 1982) 688 F.2d 815; *Appeal of Farmanfarmai, Transferee* (87–SBE–029) 1987 WL 59538 (*Farmanfarmai*).) Thus, California law applies in determining whether appellant is liable as transferee for the tax liabilities of SD-LLC.

FTB's position is that appellant is liable for the taxes of SD-LLC under the "constructive fraud test" of former section 3439.04 of the California Civil Code. That section was part of California's Uniform Fraudulent Transfer Act (the UFTA, former Civil Code sections 3439.01-3439.12), which applies in this appeal.[2]

The constructive fraud test set forth in former section 3439.04 of the California Civil Code (under the UFTA) provided, in pertinent part, as follows:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows:
>
> (a) With actual intent to hinder, delay, or defraud any creditor of the debtor.
>
> (b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation ….

FTB contends that transferee liability attaches under this provision because the transfers from SD-LLC to appellant (i.e., the profit distributions) were made "without fair consideration[[3]]

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[2] The UFTA was the successor to the Uniform Fraudulent Conveyance Act (the UFCA, Stats. 1939, ch. 329, § 7), which was codified at former Civil Code sections 3439.01 through 3439.12. Effective January 1, 2016, the UFTA was amended and renamed as the Uniform Voidable Transactions Act (the UVTA, current Civil Code sections 3439.01-3439.14). (Stats. 2015, ch. 44, S.B. 161.) However, the UFTA applies in deciding this appeal, since the transfers from SD-LLC to appellant occurred prior to the effective date of its repeal. (Civ. Code, § 3439.14(a).) We also note that many of the UVTA's provisions are substantially the same as those of the UFTA and, as a result, the UVTA provides that, to the extent that the provisions of both acts are "substantially the same," the UVTA provisions "shall be construed as restatements and continuations [of the UFTA], and not as new enactments." (Civ. Code, § 3439.14(d).)

[3] FTB's use of the "fair consideration" standard is based upon the formulation contained in the UFTA's predecessor, the UFCA. In this appeal, we apply the UFTA standard, which looks to whether the transferor received "reasonably equivalent value in exchange for the transfer." (See former Civ. Code, § 3439.04(b).)

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and [SD-LLC was] insolvent at the time of the conveyance[s] or rendered insolvent thereby."[4] For purposes of deciding this appeal, we assume that SD-LLC was insolvent at the time of the transfers or rendered insolvent thereby, and focus upon the principal issue in dispute – whether appellant provided "reasonably equivalent value" in exchange for the profit distributions from SD-LLC.

Some preliminary discussion of the burden of proof that applies in transferee liability cases is in order. Our predecessor, the State Board of Equalization (SBE), has held that in evaluating a claim of transferee liability, one applies the presumptions and evidentiary burdens that apply under the applicable state's transferee liability statute, here the provisions of the UFTA. (See *Farmanfarmai*, *supra*.) A relatively recent case applying California's UFTA held that a creditor seeking to impose liability under the UFTA "has the burden of proving the elements of a fraudulent transfer by a preponderance of the evidence," and that "[w]hile the burden of proof itself does not shift, during the progress of the case, the burden of going forward with the evidence to rebut a prima facie case may shift." (*In re 3dfx Interactive, Inc.* (Bankr. N.D. Cal. 2008 (389 B.R. 842, 863-864, affd. (9th Cir. 2014) 585 Fed.Appx. 626; cf. *Kirkland v. Risso* (1979) 98 Cal.App.3d 971, 978 [applying the UFTA's predecessor, the UFCA, court held that where it was undisputed that a transfer had occurred while the transferor was insolvent, the recipient of the transfer "had the burden of proving fair consideration for the conveyance"].)[5] We find this formulation of the burden of proof in transferee liability cases to be appropriate since the transferee – not the creditor or tax agency – presumably would have the ability to produce evidence of what consideration, if any, was provided for the transfer.

Applying these principles, we find that appellant has sustained his burden of rebutting FTB's prima facie case. The evidence shows that SD-LLC received "a reasonably equivalent value" (within the meaning of former Civil Code section 3439.04(b)) for its profit distributions to appellant. Appellant has established that: (1) the amounts that SD-LLC distributed to him

[4] FTB does not contend that SD-LLC's payments to appellant were made "with actual intent to hinder, delay, or defraud any creditor of the debtor" within the meaning of former Corporations Code section 3439.04(a)(1).

[5] Federal case law on the burden of proof in transferee tax liability cases is largely consistent. (See, e.g., *Alonso v. Commissioner* (1982) 78 T.C. 577, 583 ["All other elements of transferee liability having been shown prima facie by respondent, the burden of going forward now shifts to petitioner to establish the amount of consideration, if any, she paid …."]; *Gobins v. Commissioner* (1952) 18 T.C. 1159, 1169 [to same effect].)

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each year were payments for the services he provided to SD-LLC; [6] (2) the distributed amounts were reasonable in light of the services he rendered to SD-LLC which generated its income; and (3) he treated the distributed amounts as income from employment on his individual tax returns by paying self-employment tax thereon. As appellant explained in his reply brief:

> Appellant never received more than approximately $22,000 in a year, during the years at controversy. It would be unreasonable that individually managing and operating a business 365 days a year would not be considered as adequate consideration for a yearly amount of $22,000. Owning a business requires hard work and long hours, and such amount would likely not equal the minimum wage if the hours of Appellant for the year were calculated. Therefore, the cash assets "transferred" from [SD-LLC to appellant] were for his services rendered, and thus for full and adequate consideration.

FTB's response to appellant's arguments is that the amounts SD-LLC distributed to appellant could not have been for appellant's services because the payments were not reported as "salary" on SD-LLC's returns (Forms 568). But as a single-member LLC, SD-LLC was not required to report on its Form 568 whether the amounts paid to its single member were wages or distributed profits. (See CA LLC Tax Booklet for 2009, p. 10.) SD-LLC was a disregarded entity for most tax purposes, and its income and expenses were required to be reported on appellant's return, Schedule C. On Schedule C of appellant's return (where appellant reported SD-LLC's income and expenses), appellant reported that SD-LLC's taxable profit (of $18,474 in 2009) was distributed to him, and his return reveals that he paid self-employment tax upon that amount. Appellant also reported that he was "self-employed" by SD-LLC on his bankruptcy filings in 2009. These facts refute FTB's position that SD-LLC did not receive reasonably equivalent consideration for the amounts it paid to appellant.

Furthermore, the facts of the case that FTB relies upon to support its position, *Zubkoff*, *supra*, are readily distinguishable from the facts at issue here. The issue in *Zubkoff* was whether two 50 percent shareholders (Zubkoff and Potash) of a defunct corporation (Ralite) were liable as transferees for Ralite's unpaid tax liability (approximately $10,000) for its income year ended October 31, 1980. Because the shareholders were not liable "at law" for the obligations of the

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[6] We note that capital does not appear to have been a material income-producing factor in the generation of SD-LLC's income.

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defunct corporation,[7] the SBE analyzed whether the shareholders were liable "in equity" based upon the law of fraudulent conveyances (i.e., the UFTA). In resolving this question, the SBE focused upon the fact that Ralite had loaned the two shareholders $74,899 during the year at issue, and that this loan was outstanding at year-end. In the following tax year (after the corporate tax liability at issue had accrued), Ralite eliminated the loan from its books by making $106,200 of cash distributions to the shareholders. The shareholders argued that the loans had been made for "fair consideration"[8] because in the year after the unpaid tax liability had accrued, the shareholders had taken the loan amount into income. The SBE rejected the shareholders' argument, because as of the end of the year in which the distributions had been made and the tax liability had accrued, "[t]here [wa]s no evidence to indicate that the cash distributions were payments of salary or that Ralite received fair consideration in return." (*Zubkoff*, *supra*, 1990 WL 117932 at p. *2.) "Accordingly, because cash was distributed to the shareholders without adequate consideration and Ralite became insolvent, the shareholders are liable for Ralite's tax. Therefore, [FTB] correctly determined that appellants should be assessed Ralite's tax liability under the theory of transferee liability." (*Id*. at p. *3.)

In this appeal (in marked distinction to the facts of *Zubkoff*), the amounts distributed from SD-LLC to appellant were contemporaneously treated as employment-related income on appellant's tax returns. Appellant reported and paid self-employment tax on the amounts he received. Furthermore, the amounts distributed were reasonable in relation to the amount of time and services he provided to SD-LLC. Thus, we find that SD-LLC received reasonably equivalent value for the amounts it paid to appellant. (See also *Kardash v. Commissioner*, T.C. Memo. 2015-51 [the U.S. Tax Court, applying Florida's Uniform Fraudulent Transfer Act, holds that payments from an insolvent corporation to its shareholder-employees were not "constructively fraudulent" because the corporation received reasonably equivalent value in exchange; the payments were essentially compensation that was received in lieu of bonuses, and the corporation did not expect the bonuses to be repaid].)

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[7] Transferee liability "at law" would arise where, for example, there is a valid contract between the transferor and transferee by which the transferee assumes the tax liability of the transferor. (*Staffilino v. Commissioner*, T.C. Memo. 1992-706.)

[8] *Zubkoff* deals with the constructive fraud standard applicable under the UFCA, which speaks in terms of a "fair consideration," as opposed to the "reasonably equivalent value" formulation under the UFTA and the UVTA.

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HOLDING

Appellant is not liable as transferee for SD-LLC's tax liabilities for the 2008 through 2013 tax years.

DISPOSITION

FTB's proposed assessments are reversed.

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

We concur:

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
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Administrative Law Judge

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