

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
ERAN DRORI

) OTA Case No. 18053245
) CDTFA Case ID: 735308
) CDTFA Acct. No. 53-001524
)
)
)

OPINION

Representing the Parties:

For Appellant:

Gary M. Slavett, Esq.

For Respondent:

Mengjun He, Tax Counsel III
Stephen Smith, Tax Counsel IV
Lisa Renati, Hearing Representative

For Office of Tax Appeals:

William J. Stafford, Tax Counsel III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Eran Drori (appellant) appeals a decision issued by California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s timely petition for redetermination of an April 26, 2013 Notice of Determination (NOD). The NOD is for tax of \$234,359.01 and penalties totaling \$28,516.90, plus applicable interest, for the period April 1, 2009, through September 30, 2009 (Audit Period). The NOD reflects CDTFA’s determination that appellant is personally liable for the unpaid sales and use tax liabilities of PD Financial Corp. (PD Financial), a California corporation.

Office of Tax Appeals (OTA) Administrative Law Judges Suzanne B. Brown, Andrew J. Kwee, and Jeffrey G. Angeja, held an oral hearing for this matter in Van Nuys, California, on October 29, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). Effective July 1, 2017, functions of the BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to its predecessor, BOE.

ISSUES

1. Whether the NOD was timely issued to appellant within the applicable statute of limitations.
2. Whether appellant is personally liable for PD Financial's unpaid liabilities for the period of April 1, 2009, through June 30, 2009.

FACTUAL FINDINGS

The Business

1. PD Financial sold tangible personal property to consumers, principally over the internet. The corporation's business model generally targeted consumers with low credit ratings.
2. PD Financial's customers normally purchased goods from the corporation on credit; and PD Financial relied on financial institutions to finance the customers' purchases.
3. Appellant was PD Financial's chief executive officer (CEO) and majority shareholder, owning approximately 53 percent of the corporation's stock.
4. As CEO, appellant was in charge of the corporation's overall day-to-day operations.
5. Appellant was also involved with the corporation's quarterly budget reviews, wherein he approved quarterly budgets.²
6. Appellant concedes that PD Financial collected sales tax reimbursement on all of its retail sales of tangible personal property during the Audit Period.
7. Most of the corporation's sales ceased with the termination of the corporation's banking relationship with World Financial Capital Bank aka ADS Financial (hereinafter "ADS") during the third quarter of 2009 (3Q09).
8. PD Financial ceased business operations on or about October 30, 2009.
9. In a letter dated October 30, 2009, appellant asked "all employees to participate in an unpaid work furlough through November 15, 2009" to give the corporation time to complete negotiations with its bank and put a "new business arrangement in place."

² Appellant contends, however, that he did not have responsibility and/or knowledge of how sales taxes were reported.

10. An Automated Compliance Management System (ACMS)³ note dated January 25, 2010, documents a telephone call between CDTFA and PD Financial’s landlord during which the landlord told CDTFA that PD Financial vacated the business premises as of January 8, 2010.

Mr. Robert Malina

11. Mr. Robert Malina served as the corporation’s president and secretary. He owned approximately 30 percent of the corporation’s stock.
12. In an undated letter addressed to all employees, Mr. Malina stated, “Unfortunately, due to the unexpected cancellation of our private label bank contract . . . we are forced to terminate your employment, effective October 31, 2009.”
13. In an email dated November 24, 2009, from Mr. Malina to an individual named Joan Loof, who served as PD Financial’s chief information officer (CIO), Mr. Malina stated: “I am writing in order to clarify our intentions with respect to the future of PD Financial Corp. [¶] Ron and I believe that we will be able to resume active operations within the next 45 days.”

Mr. Daniel Grant

14. Mr. Daniel Grant served as the corporation’s chief financial officer (CFO).
15. As CFO, Mr. Grant headed the corporation’s finance operations. He had a staff of six or seven people who reported to him, including a vice president of finance, a controller, and a number of clerks.
16. Prior to the Audit Period, Mr. Grant allegedly embezzled approximately \$800,000 from PD Financial. Nevertheless, according to appellant, because Mr. Grant listed the funds as “advances” on the corporation’s books and records, the corporation never attempted to pursue criminal proceedings against him.
17. In March or April of 2009, appellant discovered Mr. Grant’s improper fund advances.
18. According to an ACMS note of a telephone call with CDTFA on December 16, 2009, Mr. Grant stated that he was no longer working for the corporation. In addition, Mr. Grant stated in the telephone call that PD Financial used to do business under the

³ ACMS is a software program used by CDTFA to document communications between compliance staff and taxpayers or their representatives.

name “Peach Direct” but was currently (at that time) known as “Venue.” Further, Mr. Grant stated in the telephone call that operations under the name Peach Direct ceased as of October 31, 2009, but that PD Financial was “still active.” An ACMS record dated December 16, 2009, indicates that CDTFA did a search for information on the status of PD Financial’s business, verifying the name change and that PD Financial was “still an active corp.”

19. According to an ACMS note of a telephone call with CDTFA on March 7, 2013, Mr. Grant stated that he met “on a weekly basis” with appellant and Mr. Malina to discuss “what needed to get paid.” Mr. Grant further stated in the telephone call that he would give appellant and Mr. Malina a report of available funds and expenses (such as rent, utilities, sales tax, etc.) that needed to be paid, and that appellant and Mr. Malina would authorize which expenses to pay.
20. In an email dated March 9, 2013, Mr. Grant stated that he met with appellant on a “daily basis to review the corporation’s cash position and the payments that were due.” Further, Mr. Grant stated in the email that he and the vice president of finance, Shiva Bahrami, “prepared extremely detailed cash flow projections” and that appellant “personally directed the accounting department on the payment of all invoices and liabilities, including items as small as \$50 and under.”

Ms. Shiva Bahrami

21. Ms. Shiva Bahrami served as the corporation’s vice president of finance.
22. In a Business Operations Questionnaire response dated September 1, 2010, Ms. Bahrami stated that appellant was one of the individuals who had “control, supervision, responsibility or duty to act for the business in sales and use tax matters when the business was terminated.”
23. According to an ACMS note of a telephone call with CDTFA on October 29, 2009, Ms. Bahrami spoke with CDTFA concerning the 2Q09 tax deficiency.

Mr. William Chao

24. Mr. William Chao served as the corporation’s controller.

25. In an undated Business Operations Questionnaire, Mr. Chao stated that appellant and Mr. Malina both had control and supervision over the corporation's sales and use tax matters when the business was terminated.
26. An ACMS note of a telephone call with CDTFA on March 7, 2013, describes that Mr. Chao stated that the following sequence of events occurred before PD Financial's original 2Q09 sales and use tax return was filed: (1) Mr. Chao asked Mr. Grant how much tax to pay before filing the corporation's 2Q09 return; (2) Mr. Grant responded by saying that he needed to ask appellant and Mr. Malina; and (3) Mr. Grant came back and told Mr. Chao that the priority in payments would be payroll first, payroll tax second, and sales tax third.
27. Mr. Chao resigned his position with the corporation on August 31, 2009.

Ms. Joan Loof

28. Ms. Joan Loof served as the corporation's CIO.
29. According to ACMS notes of a telephone call with CDTFA on March 7, 2013, Ms. Loof stated that appellant "controlled every single penny of the corporation."
30. In an email dated March 9, 2013, Ms. Loof stated that appellant was "actively involved in the daily management of the corporation."

Mr. Ty Reaber

31. Mr. Ty Reaber was employed by the corporation from July 2007 through October 2009.
32. During the Audit Period, Mr. Reaber was in charge of vendor management and dealt with the daily reconciliation of PD Financial's merchandise vendors.
33. In a declaration dated June 5, 2017, Mr. Reaber stated that the following review process was used by PD Financial on a daily basis to determine what past due liabilities would be paid: (1) the corporation's controller, Mr. Chao, would give the corporation's vice president of finance, Ms. Bahrami, a list of all past due liabilities; (2) Ms. Bahrami would then revise the list to identify which liabilities should be paid; and (3) the corporation's CFO, Mr. Grant, would then further revise the list to identify which liabilities would actually be paid. Mr. Reaber also stated that Mr. Grant had final approval on what past due liabilities to pay, except when a liability required a second signature for payment, in which case the tax liability would be brought to the attention of appellant or Mr. Malina.

Original and Amended Returns for 2Q09 & 3Q09

34. PD Financial timely filed a sales and use tax return for 2Q09, reporting tax due of \$284,853.00, of which \$257.00 was paid timely and \$50,809.99 was paid late, resulting in an unpaid tax balance of \$233,786.01 and a late-payment penalty of \$28,459.60, plus applicable interest, for 2Q09. The original return is dated July 29, 2009, and is signed by the corporation's controller, Mr. Chao.
35. PD Financial filed an amended return for 2Q09 on March 7, 2013, which reported a \$39,839 reduction to the tax balance.
36. In 2015, PD Financial filed a second amended return for 2Q09 that reported a further reduction of \$68,078 to the 2Q09 tax balance. CDTFA accepted the second amended return for 2Q09, resulting in a revised unpaid tax liability of \$125,869.01 and a revised late-payment penalty of \$17,667.90, plus applicable interest, for 2Q09. The second amended return is dated April 28, 2015, and is signed by appellant.
37. PD Financial timely filed a return for 3Q09, reporting \$61,073 tax due for the period, of which \$60,500 was timely paid, resulting in an unpaid tax balance of \$573 for 3Q09 and a late-payment penalty of \$57.30. PD Financial filed an amended return for 3Q09 dated March 6, 2013, which reported a \$573 reduction to the 3Q09 tax balance. CDTFA accepted the amended return without adjustment, resulting in no tax liability and no penalties at issue for 3Q09. Accordingly, only the unpaid liability for 2Q09 remains at issue herein.

Bank Deposits and Wage Payments

38. The corporation's checking account statement at Bank of America for the period of October 1, 2009, through October 30, 2009, lists the following summary of funds:

| | |
|-----------------------------|----------------|
| Statement Beginning Balance | \$ 131,003.47 |
| Amount of Deposits/Credits | \$2,621,893.29 |
| Amount of Checks | \$ 0.00 |
| Amount of Other Debits | \$2,688,325.19 |
| Statement Ending Balance | \$ 64,571.57 |

39. The corporation's checking account statement at Bank of America for the period of November 1, 2009, through November 30, 2009, lists the following summary of funds:

| | | |
|-----------------------------|-----|-----------|
| Statement Beginning Balance | \$ | 64,571.57 |
| Amount of Deposits/Credits | \$ | 1,485.73 |
| Amount of Checks | \$ | 0.00 |
| Amount of Other Debits | \$ | 69,952.39 |
| Statement Ending Balance | -\$ | 3,895.09 |

40. Employment Development Department (EDD) records show that PD Financial paid wages to its employees of \$1,244,177.24 for 2Q09; \$1,121,176.19 for 3Q09; and \$377,672.38 for the fourth quarter of 2009 (4Q09). Monthly wage figures for months after October 2009 are not part of the appeal record.⁴

CDTFA's Decision

41. CDTFA issued the NOD to appellant on April 26, 2013, which appellant timely petitioned. Subsequently, CDTFA issued a decision dated April 23, 2018, in which CDTFA deleted the liability for 3Q09, and reduced the liabilities for 2Q09 to \$125,869.01 in tax and a late-payment penalty of \$17,667.90, plus applicable interest. This timely appeal followed.

DISCUSSION

Issue 1: Whether the NOD was timely issued to appellant.

R&TC section 6829(f), provides that an NOD shall be mailed within three years after the last day of the calendar month following the quarterly period in which CDTFA obtains actual knowledge of the termination, dissolution, or abandonment of the business of the corporation or within eight years after the last day of the calendar month following the quarterly period in which the corporation business was terminated, dissolved, or abandoned, whichever period expires earlier.

The NOD was issued to appellant on April 26, 2013, which means that the NOD is timely only if CDTFA first obtained actual knowledge of the termination, dissolution, or abandonment of the business after December 31, 2009. CDTFA asserts that it did not know about the

⁴ We note that the wages of \$377,672.38 for 4Q09 might relate solely to the month of October 2009 (i.e., before employees were terminated on or about October 30, 2009).

termination until after CDTFA's phone call with the landlord on January 25, 2010. Appellant contends, however, that by December 16, 2009, CDTFA knew that PD Financial had terminated its business, because that is the date when the corporation's CFO, Mr. Grant, informed CDTFA that PD Financial used to do business under a different name. In addition, an ACMS note documents a November 13, 2009 phone call between CDTFA and Ms. Shiva Bahrami in which Ms. Bahrami told CDTFA that "Peach Direct is closing business operation this week and have laid off all of their employees. But the corporate officers are still at the office." Further, in a November 18, 2009 phone call between CDTFA and Ms. Bahrami, Ms. Bahrami advised CDTFA that the "business is closing down and currently they are receiving calls from other creditors demanding payments." Appellant contends that these phone calls provided CDTFA actual notice, prior to December 31, 2009, of the corporation's cessation of business activities.

Here, the evidence in the appeal record supports a finding that it was not until after December 31, 2009, that CDTFA obtained actual knowledge that PD Financial had terminated its business. For example, we note that in a telephone call with CDTFA on December 16, 2009, Mr. Grant stated that PD Financial used to do business under the name "Peach Direct" but was currently (at that time) known as "Venue." In other words, Mr. Grant's statement indicates that PD Financial did not cease its sales activity but merely changed its name. This statement provides no indication, and in fact contradicts, that PD Financial ceased the business operations for which a seller's permit was required. In addition, our finding is supported by Mr. Malina's statement in an email dated November 24, 2009 to Ms. Loof, wherein Mr. Malina asserted: "I am writing in order to clarify our intentions with respect to the future of PD Financial Corp. [¶] Ron and I believe that we will be able to resume active operations with the next 45 days."

Next, we find that Ms. Bahrami's November 13 and 18, 2009 statements to CDTFA are insufficient to establish that CDTFA had knowledge prior to December 31, 2009 of the corporation's cessation of business activities. Specifically, Ms. Bahrami stated that the corporation "is closing," but she did not identify a specific date of closure nor did she state that the corporation's business operations *had ceased*. In other words, her statement could not have provided CDTFA with actual knowledge of an event which had not yet occurred.

The record does not indicate, nor does appellant allege, that CDTFA received any additional information regarding PD Financial's status after Ms. Bahrami's statements and before the phone call with PD Financial's landlord on January 25, 2010. In summary, the

evidence in the appeal record supports a finding that CDTFA did not obtain actual knowledge that PD Financial terminated its business operations until after December 31, 2009.

Accordingly, we find that the NOD was issued to appellant in a timely manner.

Issue 2: Whether appellant is personally liable for PD Financial’s unpaid liabilities for the period of April 1, 2009 through June 30, 2009.

The law provides, in pertinent part, that any responsible person who willfully fails to pay or to cause to be paid the taxes due from a corporation shall be personally liable for unpaid taxes and interest and penalties not so paid upon termination of the business of the corporation. (R&TC, § 6829(a); Cal. Code Regs., tit. 18, § 1702.5(a).) Personal liability may only be imposed if CDTFA establishes that, while the person was a responsible person, the corporation collected sales tax reimbursement from customers (whether separately stated or included in the selling price) and failed to remit such tax when due. (R&TC, § 6829(c); Cal. Code Regs., tit. 18, § 1702.5(a).) In summary, there are four elements that must be met in order to impose responsible person liability: (1) that the corporation collected sales tax reimbursement (or incurred a use tax liability); (2) termination of the business; (3) that the person was responsible for the corporation’s sales and use tax compliance during the liability period; and (4) the person willfully failed to pay or cause to be paid. CDTFA has the burden to prove these elements by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 1702.5(d).)

Here, appellant concedes that PD Financial’s business operations terminated on or about October 30, 2009, and that PD Financial collected sales tax reimbursement from its retail sales of tangible personal property during the entire Audit Period. Thus, the only issues remaining as to the proposed tax liability are whether appellant was a responsible person and whether appellant willfully failed to pay, or to cause to be paid, PD Financial’s tax liability.

Element 3 - Responsible Person

Personal liability can be imposed only on a responsible person. (R&TC, § 6829(b).) In this context, “responsible person” means any person having control or supervision of, or who was charged with the responsibility for, the filing of returns or the payment of tax or who had a duty to act for the corporation in complying with any portion of the Sales and Use Tax Law when the taxes became due. (Cal. Code Regs., tit 18, § 1702.5(b)(1).) As relevant here, personal liability applies only if, when the person was a responsible person for the corporation, the

corporation sold tangible personal property and collected sales tax reimbursement on the selling price of the property and failed to remit such tax reimbursement when due. (Cal. Code Regs., tit. 18, § 1702.5(a).) Simply because a person was an officer, member, manager, employee, director, shareholder or partner of a business is not, in and of itself, sufficient proof to establish that the person is a “responsible person.” (Cal. Code Regs., tit. 18, § 1702.5(b)(1).) A CEO, however, is presumed to have broad implied and actual authority to do all acts customarily connected with the business, including ensuring its compliance with the Sales and Use Tax Law, even if that responsibility is delegated to others. (See *Commercial Sec. Co. v Modesto Drug Co.* (1919) 43 Cal.App.162, 173.) More than one person may be held liable under R&TC section 6829 for the same primary liability, as long as the requirements for imposing such liability on each person are satisfied. (See R&TC, § 6829.)

Appellant argues that he is not a responsible person because he did not have direct hands-on involvement with PD Financial’s sales and use tax compliance matters, and that it was the CFO’s duty to ensure the payment of taxes. We disagree, because appellant was PD Financial’s CEO. Absent an express limitation on a CEO’s duties or powers, a CEO is responsible to ensure the corporation’s sales and use tax compliance obligations, even if the CEO delegates the tasks. (See *Commercial Sec. Co. v Modesto Drug Co.*, *supra.*) Here, it is undisputed that appellant was PD Financial’s CEO, and there is no evidence or allegation that appellant’s powers and duties excluded PD Financial’s sales and use tax compliance. Accordingly, we find that appellant was a person responsible for PD Financial’s sales and use tax compliance obligations during the Audit Period.

Although the foregoing is dispositive with respect to this element, we note that the record includes unsworn statements by Ms. Loof, Mr. Grant, Mr. Chao, and Ms. Bahrami, who told CDTFA that appellant was directly involved on a daily basis with PD Financial’s sales and use tax matters. These unsworn statements are hearsay, although they have been properly admitted into OTA’s evidentiary record. (See Cal. Code Regs., tit. 18, §§ 30214 (e)(1); 30216 (d).) We note that there is no corroborating evidence to support these statements, and that they are contradicted by more persuasive evidence, such as the sworn statements of Mr. Reaber, Mr. Malina, and appellant. Furthermore, we also consider that CDTFA obtained these statements after the business had terminated, during the course of its investigation of persons to hold liable for the corporation’s unpaid liability, and the persons investigated for potential

responsible person liability would have included these corporate officers. In addition, appellant's testimony that he had no direct involvement with the corporation's sales and use tax matters is corroborated by the fact that the corporation's structure included a CFO, a Vice-President of Finance, a Controller, and several staff members, making it unlikely that appellant would have needed to be involved in the corporation's sales and use tax matters on a daily basis. In light of all of these circumstances, we give less weight to the unsworn hearsay statements, and conclude that CDTFA has not established that appellant had direct involvement with PD Financial's sales and use tax matters on a daily basis. Nevertheless, as discussed above, we conclude that appellant is a person responsible for PD Financial's sales and use tax compliance because he was PD Financial's CEO.

Element 4 - Willfulness

Finally, 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. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).) A failure to pay or to cause to be paid may be willful even though such failure was not done with a bad purpose or motive. (*Ibid.*) In order to show willfulness, CDTFA must establish 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.

(Cal. Code Regs., tit. 18, § 1702.5 (b)(2).)

Appellant contends that he did not have actual knowledge about the nonpayment of taxes for 2Q09 until the "first or second week" of November 2009, at which time no funds were available to pay the taxes. Appellant further asserts that when he first became aware of the nonpayment of taxes for 2Q09, he was told that the retail sales creating the unpaid tax balance for 2Q09 "would be subject to offset due to returns and cancellations," which appellant contends

was the reasoning he was given as to why the corporation did not originally pay the 2Q09 taxes timely.

We find that the evidence in the appeal record fails to establish that appellant had actual knowledge of the nonpayment of 2Q09 taxes before November 1, 2009. Specifically, the evidence purporting to show appellant's alleged knowledge of the unpaid liability during the Audit Period is comprised of hearsay statements, to which we give little weight, as discussed above.

We also find, however, that the weight of the evidence in the appeal record establishes that beginning on November 1, 2009, appellant had actual knowledge of the nonpayment of taxes for 2Q09. For example, appellant testified that he first became aware of the 2Q09 tax deficiency in early November 2009. Further, we note that Ms. Bahrami's telephone discussions with CDTFA concerning the 2Q09 tax deficiency occurred on October 29, 2009, which further supports our finding that appellant had actual knowledge of the nonpayment of taxes for 2Q09 starting on November 1, 2009.

As for appellant's authority to pay taxes or to cause them to be paid, we find that as CEO and majority shareholder, appellant had authority to direct affairs of the corporation throughout the Audit Period and throughout all relevant periods subsequent thereto, which included the authority to pay taxes. Nothing in the record indicates that his authority was limited.

Next, as for the availability of funds for the payment of taxes, we note that the corporation's checking account statement at Bank of America for the period of November 1, 2009 through November 30, 2009, lists the following summary of funds:

| | | |
|-----------------------------|-----|-----------------------------|
| Statement Beginning Balance | \$ | 64,571.57 |
| Amount of Deposits/Credits | \$ | 1,485.73 |
| Amount of Checks | \$ | 0.00 |
| Amount of Other Debits | \$ | 69,952.39 |
| Statement Ending Balance | -\$ | 3,895.09 (negative balance) |

Based on the corporation's checking account statement for the period of November 1, 2009, through November 30, 2009, we find that the corporation had funds available for payment of taxes in November 2009 of \$66,057.30 (i.e., \$64,571.57 + \$1,485.73 = \$66,057.30)—and neither party has demonstrated otherwise. That appellant elected to spend the available funds, and then some, paying other expenses is evidence of willfulness. Further, no

evidence of additional available corporation funds for months subsequent to November 2009 was provided and/or fully briefed on appeal.

Based on the foregoing, we find that appellant is personally liable for PD Financial’s unpaid liabilities in the amount of \$66,057.30, plus applicable interest, for 2Q09.

HOLDINGS

1. The NOD was timely issued to appellant within the applicable statute of limitations.
2. Appellant is personally liable for PD Financial’s unpaid liabilities for the period of April 1, 2009 through June 30, 2009, limited to the amount of \$66,057.30, plus applicable interest, based on the funds available when appellant acquired knowledge of the unpaid tax liability.

DISPOSITION

We sustain CDTFA’s decision to delete the 3Q09 liability, and we reduce appellant’s responsible person liability for 2Q09 to \$66,057.30, plus applicable interest. Otherwise, we deny the appeal.

DocuSigned by:

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 Jeffrey G. Angeja
 Administrative Law Judge

We concur:

DocuSigned by:

 47F45ABE89E3460
 Suzanne B. Brown
 Administrative Law Judge

DocuSigned by:

 3CADA62FB4864CB
 Andrew J. Kwee
 Administrative Law Judge

Date Issued: 1/27/2020