

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

M. SAVAGE) OTA Case No. 18012052
) CDTFA Case ID: 731466
) CDTFA Account No. 53-011225
)
)
)
)**OPINION**

Representing the Parties:

For Appellants:

A. Lavar Taylor, Attorney
Lisa O. Nelson, Attorney

For Respondent:

Chad T. Bacchus, Tax Counsel IV
Scott Claremon, Tax Counsel IV
Jason Parker, Chief of Headquarters
Operations

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, M. Savage (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying, in substantial part, appellant's petition of a Notice of Determination (NOD) dated April 3, 2013. The NOD is for \$153,964.83 in tax, \$30,207.08 in penalties, plus applicable interest, for the period July 1, 2007, through December 14, 2009 (liability period). The NOD reflects CDTFA's determination that appellant is personally liable as a responsible person for the unpaid taxes, plus penalties thereon, that Bella Famiglia, Inc. (BFI) accrued during the liability period. Only the penalties, totaling \$8,328.28, are at issue in this appeal.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Kenneth Gast, and Suzanne B. Brown held an oral hearing for this matter in Cerritos, California, on

¹ Sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, certain functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When this opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board, to the extent those acts or events would have been performed by CDTFA on and after July 1, 2017.

August 19, 2020.² At the conclusion of the hearing, the record was closed, and this matter was submitted for a decision.

ISSUES

1. Whether OTA has jurisdiction to resolve this appeal.
2. Whether appellant's personal liability for the penalties incurred by BFI was discharged in bankruptcy.

FACTUAL FINDINGS

1. BFI operated a restaurant in Huntington Beach, California, from September 7, 2005, until December 14, 2009, when it terminated its business operations.
2. During the liability period, BFI incurred penalties when it failed to file returns, filed returns untimely, and filed non-remittance returns. Additionally, BFI incurred a finality penalty when it failed to timely pay a CDTFA-assessed liability for the third quarter of 2008 (3Q08).
3. Appellant was BFI's Chief Executive Officer, Chief Financial Officer, and a 40.5 percent owner of the corporation. Appellant also signed checks payable to CDTFA for sales and use taxes and discussed BFI's unpaid taxes with CDTFA during the liability period. BFI paid over \$2,000,000 to creditors other than CDTFA during this period.
4. On August 31, 2011, appellant filed a voluntary Chapter 7 bankruptcy petition with the United States Bankruptcy Court, Central District of California. Appellant listed a "Sales Tax Debt" to CDTFA of \$155,908.73, for the period 2007 to 2009, as an unsecured priority claim.
5. On December 22, 2011, the Bankruptcy Court granted appellant a discharge under section 727 of title 11 of the United States Code. The discharge order states that the "discharge prohibits any attempt to collect from the debtor a debt that has been discharged." The discharge order further explains that "[m]ost, but not all, types of debts are discharged if the debt existed on the date the bankruptcy case was filed." The discharge order goes on to state: "**Debts that are not discharged [include]** a. Debts for most taxes." (Original bold and underscoring.)

² Due to the COVID-19 pandemic, the oral hearing was conducted electronically with the agreement of the parties.

6. On April 3, 2013, CDTFA issued an NOD to appellant holding him personally liable as a responsible person under R&TC section 6829 for the unpaid liabilities of BFI, which appellant timely petitioned.³
7. On December 30, 2015, CDTFA issued a Decision and Recommendation (referred to above as the decision) deleting appellant's responsible person liability for 2009, and otherwise denying the petition.
8. Subsequently, on April 28, 2017, CDTFA issued a supplemental decision also deleting appellant's responsible person liability for 4Q08.
9. Thereafter, on May 26, 2017, CDTFA issued a notice to appellant reflecting a revised balance, after deleting 2009 and 4Q08. According to the notice, the remaining responsible person liability for the period July 1, 2007, through September 30, 2008, consists of \$43,979.83 in tax, \$8,328.28 in penalties, plus accrued interest.⁴
10. This timely appeal followed. On appeal, appellant concedes that he is personally liable as a responsible person for BFI's remaining unpaid taxes and interest, and that the tax and interest liability was not discharged in bankruptcy. Only the penalties are at issue. Appellant disputes his remaining responsible person liability for BFI's unpaid penalties on the basis that the penalties (but not taxes and interest) were discharged pursuant to the December 22, 2011 discharge order.
11. On January 30, 2020, the parties were asked to provide additional briefing on whether OTA has jurisdiction to address the issue presented in this appeal. This matter was thereafter postponed from the February 2020 oral hearing calendar to allow the parties time to submit additional briefing.

DISCUSSION

Section 523(a)(1) to (19) of title 11 of the United States Code (Bankruptcy Code) identifies tax liabilities which are excepted from discharge under the Bankruptcy Code.

³ The NOD issued to appellant does not include a breakdown of the penalties.

⁴ Both parties contend that BFI's unpaid penalties for the period July 1, 2007, through September 30, 2008, consists of a late payment or late filing penalty of \$4,110.60 for 3Q07, \$3,542.80 for 4Q07, and \$348.38 for 1Q08, and a finality penalty of \$362.50 for 3Q08. This amounts to \$8,364.28. According to CDTFA's May 26, 2017 notice, the penalty amount for which CDTFA is holding appellant personally liable is \$8,328.28. There is no documentation in the record to explain the \$36 discrepancy. During the oral hearing, CDTFA indicated that the lesser amount is the correct amount.

Appellant concedes that the liability for sales and use tax, plus interest, for which he is being held personally liable was not discharged in bankruptcy. Appellant only disputes whether his personal liability for the penalties was discharged. Appellant contends that dischargeability of penalties are addressed under section 523(a)(7)(B) of the Bankruptcy Code, and that the facts of this case do not meet the requirements to be excepted from discharge and, as such, the debt is dischargeable. CDTFA disagrees with appellant's interpretation and contends that the debt was excepted from discharge.⁵

Appellant cites to *In re Ilko* (2011) 651 F.3d. 1049,⁶ and concedes that in this case the United States Court of Appeals for the Ninth Circuit addressed the specific issue of whether a responsible person's liability imposed under R&TC section 6829 is non-dischargeable on the basis that their personal liability is assessable but not yet assessed under Bankruptcy Code section 523(a)(1)(A), which incorporates section 507(a)(8)(iii). The court concluded that the relevant trigger for purposes of determining whether the tax liability is still assessable, and thus excepted from discharge under these Bankruptcy Code sections, is the date of termination of the corporation, as opposed to the corporation's due date to file a return or pay the tax. (*Id.* at p. 1059.) *In re Ilko, supra*, however, did not address penalties because CDTFA conceded the penalties. The dispute before OTA involves whether the relevant trigger is the termination of the corporation (CDTFA's position), or the corporation's failure to timely file a return or pay the tax (appellant's position) for purposes of determining dischargeability of penalties under Bankruptcy Code section 523(a)(7).

Issue 1: Whether OTA has jurisdiction to resolve this appeal.

As a preliminary matter, before addressing the substantive question of whether the penalties were excepted from discharge under the Bankruptcy Code, we must first determine

⁵ CDTFA did not brief the issue of whether the penalties at issue may be excepted from discharge under Bankruptcy Code section 523(a)(1) or 523(a)(7)(A). (See also 11 U.S.C. §§ 507(a)(8)(A)(iii), and 507(a)(8)(G).) During the oral hearing, CDTFA indicated it was relying on Bankruptcy Code section 523(a)(7)(B) and did not address any alternative exceptions to discharge.

⁶ This case that appellant cites is an unpublished opinion. It involves a different taxpayer who was also represented by appellant's attorney, A. Lavar Taylor, before CDTFA in a responsible person matter. OTA does not have any rules addressing citation of unpublished opinions. In comparison, Federal Rule of Appellate Procedure 32.1 permits citation to federal courts of appeals opinions issued in 2007 or later. In fact, the *re Ilko* opinion states that "[a]lthough it may be cited for whatever persuasive value it may have (see Fed. R.App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1." (*In re Ilko, supra*, 651 F.3d. 1049, fn 1.) Rule 8.1115 of the California Rules of Court prohibits citation of unpublished California Court of Appeal of superior court appellate division opinions, but does not prohibit the citation of unpublished federal opinions.

whether OTA has jurisdiction to resolve the bankruptcy issue presented in this appeal. Presented today is a novel issue because neither the board nor OTA has issued any precedential opinions addressing its jurisdiction to resolve issues concerning dischargeability of sales and use tax liabilities, including penalties, under the Bankruptcy Code. As a general matter, the bankruptcy court has concurrent jurisdiction with state courts to determine whether a tax debt is discharged under Bankruptcy Code section 523(a)(1). (*In re Aldrich* (B.A.P. 9th Cir. 1983) 34 B.R. 776, 779-780.) Such jurisdiction to interpret Bankruptcy Code section 523(a) is the same regardless of whether the applicable tax is an income tax or a sales tax. As such, it is appropriate for us to consider precedent involving income tax appeals.

OTA's predecessor, the board, issued precedential opinions addressing the board's jurisdiction to address issues of dischargeability of tax liabilities under the Bankruptcy Code, when deciding franchise and income tax appeals. Precedential decisions of the board may be cited as precedent to OTA. (Cal. Code Regs., tit. 18, § 30504.) In the frequently cited case *Appeal of Smith* (81-SBE-145) 1981 WL 11870 (*Appeal of Smith*), the board concluded that it lacked jurisdiction to determine if a personal income tax liability had been or should have been discharged in bankruptcy. On the other hand, in an earlier but rarely, if ever, cited precedential case, *Appeal of Willett* (76-SBE-073) 1976 WL 4089 (*Appeal of Willett*), the board concluded that its exercise of jurisdiction to determine whether a personal income tax liability had been discharged in a Chapter 11 individual bankruptcy proceeding was necessary for proper disposition of an appeal.⁷ The board opined that exercising jurisdiction did not constitute a usurpation of the jurisdiction conferred upon the bankruptcy court "to determine the dischargeability of particular debts during a bankruptcy proceeding." (*Ibid.*) In a later case, *Appeal of Amrep, Inc.* (98-SBE-002) 1998 WL 98767 (*Appeal of Amrep*), the board cited to *Appeal of Smith, supra*, and reaffirmed that the board lacks jurisdiction to determine whether a debt is excepted from discharge under the Bankruptcy Code. As such, in its issuance of the decisions in *Appeal of Smith* and *Appeal of Amrep*, the board at least implicitly reversed the

⁷ In *Appeal of Willett*, the board summarized the pertinent bankruptcy law at the time as follows: "the confirmation of a Chapter XI arrangement does not discharge the debtor from any debts or liabilities which are not provided for by the arrangement or which are not dischargeable pursuant to section 17 of the Bankruptcy Act." The board went on to opine that the taxpayer's personal income taxes were not discharged in bankruptcy because they were not provided for in the Chapter XI arrangement and were also non-dischargeable under section 17 of the Bankruptcy Act (as applicable in 1976).

earlier proposition in *Appeal of Willett* that it has jurisdiction to determine if a debt was excepted from discharge.⁸

OTA has jurisdiction to resolve appeals involving California taxes, including state franchise or income tax appeals, and sales and use tax appeals. (Gov. Code, §§ 15671(a), 15672(b).) However, OTA is not a court, and there is no statute which grants OTA subject matter jurisdiction to resolve contests as to dischargeability of tax debts under the federal Bankruptcy Code. (Gov. Code, § 15672(b); see Gov. Code, § 15670 et seq.) Contests to dischargeability may be brought in either an appropriate state court or in the bankruptcy court and may be brought before or after a discharge has been granted. (*In re Aldrich, supra*, at p. 779.) As indicated in *In Re Ilko*, one method to resolve a question of whether a debt was discharged or is non-dischargeable under the Bankruptcy Code is for the debtor to “reopen[] his bankruptcy case . . . and file[] an adversary complaint seeking a determination that his tax debt was discharged.” (*In Re Ilko, supra*, 651 F.3d at p. 1050.)⁹ Consistent with *Appeal of Smith*, we conclude that OTA lacks jurisdiction to determine whether appellant’s liability for the penalties at issue here was either discharged, or excepted from discharge, under the Bankruptcy Code. To the extent of any inconsistency between *Appeal of Smith* with *Appeal of Willett*, we find that *Appeal of Smith* is more persuasive because it was decided more recently and is cited frequently, whereas *Appeal of Willett* is an obscure case which, to our knowledge, has not been cited in any other opinion. Therefore, to the extent this opinion is inconsistent with *Appeal of Willett*, *Appeal of Willett* is overturned.

Appellant contends that the board routinely decided issues involving dischargeability of tax liabilities in bankruptcy for business tax appeals and, as the successor to the board, OTA retains the board’s jurisdiction to address such matters. Both CDTFA and OTA are successors to the board. OTA is the successor to the board with respect to all the duties, power, and responsibilities of the board necessary or appropriate to conduct appeals hearings. (Gov. Code,

⁸ In *Appeal of Amrep*, the board drew a distinction between Chapter 11 individual proceedings versus Chapter 11 corporate proceedings, on the basis that Chapter 11 corporate proceedings do not involve determining if a debt is non-dischargeable. This implicitly conflicts with *Appeal of Willett*, where the board exercised jurisdiction over a Chapter 11 individual proceeding (see footnote 7, *ante*). However, the board ultimately dismissed the *Appeal of Amrep* as moot, because both parties failed to respond to the board’s request for additional briefing on the bankruptcy matter.

⁹ During the oral hearing, appellant’s representative stated that this would be an option for appellant to pursue in the event OTA lacks jurisdiction to resolve this appeal.

§ 15672(a).) CDTFA is the successor to the board with respect to the administration of the Sales and Use Tax Law. (Gov. Code, § 15570.22.) In deciding bankruptcy matters impacting the business tax programs for which the board was responsible, the board was performing an administrative function. In other words, the board was required by statute to administer the Sales and Use Tax Law. (R&TC, § 7051.) Deciding whether to pursue an NOD when a taxpayer files for bankruptcy was a responsibility that the board was statutorily obligated to perform as a part of its duty to administer the Sales and Use Tax Law. On the other hand, the board served in an appellate function with respect to deciding franchise and income tax appeals because it was reviewing the actions of a separate tax agency. (See R&TC, §§ 19045, 19324.) The Taxpayer Transparency and Fairness Act of 2017 (Stats. 2017, Ch. 16) bifurcated the appellate and administrative functions of the board and transferred only the appellate functions to OTA.

OTA has no statutory authority to administer the Sales and Use Tax Law. OTA also has no statutory obligation to adjudicate disputes over application of the United States Bankruptcy Code. These types of disputes are resolved by the United States bankruptcy courts. By the time an appeal that also involves a bankruptcy action comes before OTA, CDTFA has already acted on the bankruptcy matter, issued an NOD, and rendered a decision on the substantive merits of the NOD. OTA's responsibility is to conduct and decide the appeal pursuant to the Revenue and Taxation Code. Therefore, with respect to appeals from CDTFA, we will follow the established franchise and income tax precedent holding that the board (and, as its successor, OTA) lacks jurisdiction to decide whether a proposed assessment was discharged in bankruptcy. In reaching our decision herein, we consider important it that OTA's statutory authority is limited to conducting and deciding appeals, and the significant amount of precedent holding that the board, which served in a similar capacity while presiding over franchise and income tax appeals, lacked jurisdiction to address bankruptcy matters. Therefore, we find that OTA lacks jurisdiction to resolve the bankruptcy issue raised by appellant.

Issue 2: Whether appellant's personal liability for the penalties incurred by BFI was discharged in bankruptcy.

Based on our finding that we lack jurisdiction to resolve this appeal, we need not address the substantive issue of whether appellant's responsible person liability for BFI's penalties was discharged in bankruptcy. Appellant does not otherwise dispute the liability as determined by CDTFA; thus, there are no issues for OTA to address and this appeal may be dismissed.

HOLDING

OTA lacks jurisdiction to determine whether all or any portion of appellant’s liability was discharged in bankruptcy.

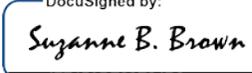
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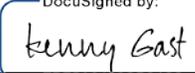
The appeal of CDTFA’s action is dismissed.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Suzanne B. Brown
Administrative Law Judge

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Kenneth Gast
Administrative Law Judge

Date Issued: 9/23/2020