

Memorandum

170.0002.050

To : Mr. Steve Adams
Supervising Tax Auditor

Date: April 7, 1998

From : Thomas J. Cooke
Tax Counsel

Telephone: (916) 445-6496
CalNet 485-6496

Subject : D--- C. and J--- C. H---, et al.
Permit No. SR -- XX-XXXXXX-010

Gary Jugum has requested that I respond to your memorandum to him dated April 3, 1998 concerning the above account.

In your memorandum, you state that a Notice of Determination was issued to the taxpayers (M--- and V--- S---) for the period October 1, 1990 to February 28, 1991 on November 14, 1991. A timely Petition for Redetermination was filed by these taxpayers on December 14, 1991.

On September 12, 1989, J--- C--- M---, a California general partnership, had filed Chapter 11 bankruptcy. M--- and V--- S--- along with two other couples had operated this business as a partnership. Sometime in early 1990, the [S---] and [G--- and C--- H---] were ousted from the business by [D--- and J--- H---] in an attempt by the [H---] to formulate a Chapter 11 plan of reorganization. [D--- and J--- H---] then failed to file returns for the business for the period from October 1, 1990 to February 28, 1991. On October 24, 1991, the Chapter 11 bankruptcy action was converted to a Chapter 7 action. On September 11, 1997, a discharge was granted in the Chapter 7 action and the case was closed.

You ask that the Legal Section advise 1) if the liability should be cancelled, 2) if the liability is subject to discharge, or 3) if the matter can proceed to a Board Hearing.

On November 14, 1991, the Board issued a Notice of Determination to J--- C--- M--- and to the six partners in the partnership, [D--- C. and J--- C. H---], [M--- and V--- S---] and [G--- and C--- H---]. At the time that the Notice of Determination was issued, J--- C--- M---, a California general partnership, was in bankruptcy and the "automatic stay" was in effect as to this entity. The individual partners had not filed bankruptcy and the issuance of the Notice of Determination to these partners did not violate an "automatic stay."

It is our opinion that the Notice of Determination issued to J--- C--- M---, a California general partnership, should be cancelled. [M--- and V--- S---] have alleged in their Petition for Redetermination that they were ousted from the business prior to the period specified in the Notice of Determination and that they should not be held liable for the failure of the [H---] to file returns for that period.

It is our opinion that the petitioned liability imposed on the [S---] should not be cancelled, was not subject to discharge in the J--- C--- M--- bankruptcy action and that this matter should proceed to a Board Hearing.

TJC/cmm
Attachments

cc: Mr. E. V. Anderson (KH)
Mr. Jerry W. Cornelius (MIC:49)
Mr. Philip Spielman (MIC:38)
Mr. Paul Erickson (MIC:38)
Ms. Janeth Z. Brouwer (MIC:38)

Memorandum

170.0002.050

To : Mr. Philip Spielman
Supervisor, Petitions Section (MIC: 38)

Date: May 13, 1998

From : Thomas J. Cooke
Tax Counsel

Telephone: (916) 445-6496
CalNet 485-6496

Subject: Request for Clarification of
Prior Legal Opinion Dated April 7, 1998
D--- C. and J--- C. H---, et al
Permit No. SR -- XX-XXXXXX-010

Gary Jugum has requested that I respond to your memorandum to him dated May 12, 1998 concerning the above taxpayers.

In your memorandum, you state that your section seeks assistance regarding procedures to follow under the Bankruptcy Code in this appeal. On April 3, 1998, your section submitted a memorandum to the Legal Section requesting guidance on how to proceed with the appeal. The Legal Section's opinion, dated April 7, 1998, recommended that the Notice of Determination issued to J--- C--- M---, a California general partnership, should be canceled, but the liability imposed on the S--- should not be canceled. You state that the Board has only one determination. As a Board policy, the individual partners receive a copy of the Notice of Determination issued to partnerships. Since the S--- are one set of partners, they received a copy of the determination.

You also state that the bankruptcy trustee made payments of \$11,497.92 from December 1991 through October 1996, and it seems that by making the payments the Trustee validated the Board's claim. In addition, the prepayment of \$3,500.00 made for the fourth quarter 1990 was applied to the determination.

You ask for confirmation of the prior advice to cancel the determination, and if the determination is to be canceled, should the Board refund the payments to the partnership.

When the Board issues a permit to a partnership, it establishes only one account for the partnership, although both the partnership and the individual partners may become liable for the taxes due from the partnership's business. When the Board issued the Notice of Determination

to this partnership and its partners, it sought to assess liability for the partnership business on both the partnership and on the individual partners. If the Board is unable to collect the liability from the partnership, it may attempt to collect the liability from the individual partners. The Board issued the Notice of Determination to the partnership while the partnership was protected by the bankruptcy "automatic stay." When we recommended that the Notice of Determination be canceled as to the partnership, we meant that the partnership entity should be considered to have no further liability to the Board, and that the Board should consider only the individual partners to be subsequently liable for the determined liability on the account. A husband and wife may be permitholders on one account. When the Board grants innocent spouse relief, it "cancels" the liability of the innocent spouse on the account and thereafter attempts to collect the liability only from the other spouse.

A refund can only be made "from the person from whom the excess amount was collected or by whom it was paid" (Rev. & Tax. Code § 6901). The S--- contend that they were ousted from the business in early 1990. The S--- are not entitled to a refund of any amounts paid or applied to the determination since they had been removed from the partnership prior to these payments to the Board.. In addition, it appears that the S---, in contending that they should not be held liable for "predecessor liability," are not disputing the nature or amount of the determination nor are they representing the partnership entity or the other partners in the present appeal. The determined liability should be deemed to be a "final liability" as to the partnership entity and the other partners. As such, the period for which the partnership entity or the other partners may file a claim for refund has expired (see Rev. & Tax. Code § 6902).

It is our recommendation that the liability of J--- C--- M---, a California general partnership, be canceled, that the petitioned liability imposed on the S--- should not be canceled, and that the appeal proceed to a Board hearing. It is also our recommendation that no refund be made to the partnership.

TJC:sr

cc: Mr. J. W. Cornelius, Headquarters Operations Manager (MIC:49)
Mr. Philip Spielman, Supervisor, Petitions Section (MIC:38)
Mr. E. V. Anderson, Sacramento District Administrator (KH)
Mr. Paul Erickson, Petitions Section (MIC:38)
Ms. Janeth Z. Brouwer, Petitions Section (MIC:38)