May 20, 2022

VIA INTERNET

Dear Interested Party:

The Compliance Policy and Procedures Manual (CPPM) is a guide for the California Department of Tax and Fee Administration (CDTFA) in administering tax and fee programs. It is available to the public and can be accessed from the CDTFA web page at http://www.cdtfa.ca.gov/taxes-and-fees/staxmanuals.htm.

The Business Tax and Fee Division is proposing to revise CPPM sections 726.010-726.033 to incorporate current policies and procedures relating to accounts held by corporations.

The revision material is provided on the following pages for the convenience of interested parties who may wish to submit comments or suggestions. Please feel free to publish this information on your website or otherwise distribute it to your association/members.

If you have any comments or suggestions related to the proposed CPPM revisions, you may contact the CDTFA at CPPMRev@cdtfa.ca.gov. Your comments or suggestions must be received by the CDTFA no later than June 20, 2022, to be considered. Thank you for your consideration.

Sincerely,

Aimee Olhisier, Chief
Tax Policy Bureau
Business Tax and Fee Division
CORPORATE COLLECTIONS  726.000
GENERAL  726.010

**RTC** Revenue and Taxation Code (RTC) section 6005 recognizes a corporation as a “person” separate and distinct from its members, stockholders, directors, or officers. Generally, a corporate liability is collectable only from assets of the corporation. Although personal liability for amounts owed by a corporation can be asserted against members, stockholders, directors, or officers under certain conditions, they do not acquire personal liability solely through affiliation with the corporate entity.

When a corporation has no assets, is defunct, or when personal liability cannot be asserted against the corporate officers, there is no source from which collection can be made. Therefore, to minimize losses arising from delinquent corporate liabilities, it is necessary to take appropriate actions when registering the account first in contact with the corporation, such as:

1. If financial documentation is provided by the applicant, thoroughly analyzing the corporation’s financial status when the corporation applies for a permit
2. Obtaining an adequate security deposit.
3. Reappraising the security requirements whenever
4. Documenting all responsible parties and verifying that it is the normal practice of the corporation to collect tax reimbursement.

**ACTIVE ENTITIES AND RTC SECTION 6829**

A “dual determination” is a determination made against a person for a tax liability that is also the obligation of another person. Under RTC section 6829, a corporate officer or other person may be held personally liable for the tax liability of the corporation if certain criteria are met (see CPPM section 764.030 et seq. for information on dual determinations).

The best time to gather evidence to support personal liability under RTC section 6829 is while an entity’s business is active. While working an active entity’s account, staff should ask and document in ACMS the answers to the following questions:

- Who is responsible for sales and use tax matters? When did the responsibility begin? Who ultimately determines which bills get paid? Is this person aware of the delinquency/liability owed?
- Is the corporate officer/member/partner information on record with the CDTFA current? If it is not, obtain what is necessary to update the information in the CDTFA’s registration system. The start and end dates for each officer/member/partner should be entered into ACMS and IRIS. CDTFA current? If it is not, obtain the necessary information to update CDTFA's
registration in the system. What are the start and end dates for each officer/member/partner?

- Does the entity add sales tax reimbursement to its sales? If so, request a copy of an invoice or receipt that demonstrates how tax is reimbursed. Does the entity collect use tax on its sales? If so, request a copy of an invoice or receipt. Does the entity collect sales tax from its customers? If so, request a copy of an invoice or receipt showing tax reimbursement collected. Does the entity collect use tax on its sales? If so, request a copy of an invoice or receipt. Upload these copies to the system.

- What other bills are currently being paid? If the taxpayer is requesting a payment arrangement and financial information is being requested, the material should be retained in the case drop file until the liability is paid in full. Once the liability is paid, all documents should be sent to the Taxpayer Records Unit and notes should be entered into ACMS. Document should be uploaded as an attachment to the Customer springboard.

If staff is made aware of an impending closeout of an entity’s business, staff should inform officers/member/partners of RTC section 6829 and its implications should any outstanding liability of the entity remain unpaid when the entity’s business terminates. If a team member is made aware of an impending closeout of an entity’s business, the officer, member, or partner should be informed of RTC section 6829 and its implications, should any outstanding sales and use tax liability of the entity remain unpaid when the entity’s business terminates. For information about issuing a dual determination under RTC section 6829, see CPPM section 764.080.

**REQUIREMENTS TO QUALIFY AS A CORPORATION**

726.020

A corporation is formed after filing articles of incorporation with, and receiving a corporate charter from, the Secretary of State’s office. A corporation does not legally exist until this process is complete. If the unincorporated entity begins to make retail sales, or purchases of tangible personal property for self-consumption in California without payment of use tax, a dual determination for sales or use taxes applicable to those sales or purchases should be issued against the individual owner(s), sole proprietorship(s), partnership(s), joint venture(s), or other entities comprising the ownership of the business.

If an entity, after obtaining a seller’s permit as a corporation, is found to actually be an unincorporated entity, a dual determination should be issued against the true owners of the business, e.g., a sole proprietorship, an individual or individuals, a partnership, a joint venture or other entity. For purposes of tax administration, a foreign corporation that has not registered with the California Secretary of State is an incorporated entity, although it is not qualified to conduct business in this state.

Under RTC section 23301, a corporation may have its active status suspended for a variety of reasons. If a corporation is suspended, the liability for payment of sales and use taxes becomes the obligation of the individual members, stockholders, directors, or officers for the period in which the corporation is suspended. Certain requirements must be satisfied prior to issuing a determination against a corporate officer or officers of a suspended corporation (see CPPM section 764.060).
INCORPORATION WITHOUT NOTIFICATION TO THE CDTFA 726.030

Occasionally, an individual or partnership will obtain a seller’s permit and then incorporate without notifying the CDTFA of the change. The newly formed corporation is a separate “person” under RTC section 6005, and is required to obtain a new permit. If a liability is disclosed that was incurred after the date of incorporation, staff will assess the liability against the corporation by issuing a new permit to the corporation or through use of an “arbitrary” permit number. Team members will request the individual or partnership to register for a new permit and transfer the liability to the corporation using a CDTFA-523, Tax Return And/Or Account Adjustment Notice. If the taxpayer refuses to obtain a new permit, team members may create an account using the procedures under CPPM section 295.090.

If the liability is uncollectible from the corporation, a report may be sent to the Collections Support Bureau (CSB) requesting a dual determination against the entity to which the initial permit was issued (the predecessor). The basis for issuing a dual determination against the predecessor is that the taxpayer’s failure to notify the CDTFA of the incorporation deprived the CDTFA of an opportunity to obtain an adequate security deposit resulting in a loss to the state. To request a dual determination in the above circumstance, notify the CSB by sending a memorandum along with supporting documentation.

BUSINESS CONVERSIONS, MERGERS, AND ACQUISITIONS 726.033

OVERVIEW

There are various forms of business entities recognized in California. They are: corporations, partnerships, limited partnerships, limited liability companies (LLCs), and limited liability partnerships. As discussed below, the first four entity forms can participate in various transactions that may affect their status, including merger, conversion, and acquisition, all as provided in the California Corporations Code (CCC). Limited liability partnerships, however, are precluded from some such transactions. (There are also sole proprietorships, the treatment of which is discussed below.) A merger involves two or more entities while a conversion involves only one. A merger, or merger reorganization, is the absorption of one entity by another that survives, retains its name and identity, together with the added capital, franchises, and powers of the merged (or disappearing) entity, and continues the combined business. The merged entity ceases to exist, and the merging entity alone survives. Thus, the surviving entity acquires all rights and property of the disappearing entity and is subject to all debts and liabilities of the disappearing entity (as if the surviving entity had itself incurred them).

In a conversion, the entity that converts into another is, for all purposes, the same entity that existed before the conversion, except that the form of business organization (and possibly the name) has changed. In both cases, the debts and obligations of the former entity become the debts and obligations of the new or surviving entity. A limited liability partnership, however, is precluded from converting into another form of business entity. Since the debts and obligations of the former entity become the debts and obligations of the converted or merged entity, it is inappropriate to issue successor billings or dual determinations to transfer or replicate a liability established against the former entity to the converted or merged entity. If the liability of the disappearing entity has gone final, these merged or converted entities are not entitled to the statutory 30-day petition rights accorded rightful dualees or successors. Instead, a demand billing (that includes
information regarding the conversion and a reference to the origin of the liability) will be sent to the surviving or converted entity for payment of the liability incurred by the former entity. If a demand billing needs to be sent to a converted entity, a memo or email request should be sent to the Collections Support Bureau (CSB). An email request should be sent to CSB with all pertinent information included such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation, and information sources, etc. Any other evidence, such as written statements or documents should also be forwarded.

There are also two types of acquisitions. One involves the acquisition of the shares of a stock of a corporation (also known as an “exchange reorganization”), and the other involves the acquisition of the assets of a corporation (a “sale-of-assets reorganization”). Thus, when one person or entity acquires all of a corporation’s shares of stock from others, the corporate form remains intact, and only the shareholders have changed. The corporation has been acquired by new owners, but it retains its identity. Therefore, if the corporation holds a seller’s permit with the CDTFA, that permit should continue in CDTFA, that permit should remain valid with the corporation’s name. Alternatively, in the case of a “sale-of-assets reorganization,” when any form of business sells its assets (as opposed to sale of its shares or membership interests), the provisions of Revenue and Taxation Code (RTC) sections 6811-6814 and Regulation 1702 may apply, leading to the issuance of a successor determination. Specific types of each of these transactions (along with instructions for registration and billing requests once a transaction has occurred) are discussed below.

**STATUTORY MERGERS**

Statutory mergers follow the provisions set forth in the CCC for the given type of entity different types of entities. For a merger to be valid, the merged entities must have followed the requirements set forth in the CCC.

Statutory provisions governing merger reorganization for corporations are set forth in the CCC, Chapter 11, and specify the statutory legal formalities required to merge a corporation with another corporation or other business entity in California. Two or more corporations may be merged into one of those corporations. The board of each corporation seeking to be merged must approve an agreement of merger. As set forth in section 1107(a) of the CCC, once a statutory merger has occurred, the merged or disappearing corporation no longer exists and the surviving corporation succeeds to all the rights and property of the disappearing corporation and is subject to all of the debts and liabilities of the disappearing corporation (as if the surviving corporation had itself incurred them).

Mergers of limited partnerships are authorized pursuant to section 15911.10 of the CCC. Mergers of partnerships are authorized pursuant to section 16910. Mergers of LLCs are authorized by section 17710.10. With respect to mergers of each of these forms of entity, the surviving entities are subject to debts and liabilities of the disappearing entity, as if the surviving entity had incurred them.

There is no authority for mergers of limited liability partnerships.

Another type of statutory merger is called “short-form merger,” which is a merger of a parent corporation with one or more wholly owned subsidiaries, or the merger of a parent corporation and one or more subsidiaries of which the parent corporation owns at least 90%, but not all, of the outstanding shares of each class.
Registration for Mergers
In a statutory merger, the merged corporation ceases to exist. CDTFA staff members should close out the CDTFA account(s) of the disappearing corporation and document that the accounts were merged into the surviving corporation and its CDTFA account(s).

CONVERSIONS
Conversions of corporations are governed by sections 1150-1160 of the CCC. In a conversion, the entity that converts into another is, for all purposes, the same entity that existed before the conversion, except that the form of business organization (and possibly the name) has changed. A corporation may be converted into a “domestic other business entity” if the shares of the converting corporation are treated in conformity with CCC section 1151 in that: (1) each share of the same class of the converting corporation is treated equally with respect to any cash, right, securities or other property to be received and (2) nonredeemable common shares of the converting corporation are converted into non-redeemable equity securities of the converted entity. An entity in California that wishes to convert to another domestic entity must approve an approved plan of conversion that states all of the following:

- The terms and conditions of the conversion.
- The jurisdiction of the organization of the converted entity and of the converting corporation and the converted entity and of the converting corporation, and name of the converted entity after conversion.
- The manner of converting the shares of each of the shareholders of the converting corporation into securities of, or interests in, the converted entity.
- The provisions of the governing documents for the converted entity, including the partnership agreement or LLC articles of organization and operating agreement, to which the holders of interests in the converted entity are to be bound.
- Any other details or provisions that are required by the laws under which the converted entity is organized, or that are desired by the converting corporation.

Conversions of limited partnerships are authorized pursuant to CCC section 15911.02. However, a limited partnership may not convert to a limited liability partnership (CCC section 16955). Conversions of general partnerships are authorized pursuant to CCC section 16902. Conversions of LLCs are authorized by CCC section 17710.02. With respect to conversions of each of these forms of entity, the converted entities are subject to all debts and liabilities of the converting entity, as if the converting entity had incurred them.

There is no authority for conversions of limited liability partnerships.

Registration for Conversions
In this type of situation, it is not necessary to close out the account(s) of the converting entity and issue a new account(s). The name of the entity and type of business may need to be changed on the account(s). If a sole proprietor decides to incorporate or form some other type of business entity (such as a partnership, limited partnership, or LLC), that is not a conversion. Staff should close out the account(s) of the sole proprietor and issue a new account(s) to another type of business entity (such as a partnership, limited partnership, or LLC), it is not considered a conversion. Team members should close the account(s) of the sole proprietor and have the taxpayer register a new account(s) for the new entity. There would be no question of the liability of the individual for taxes and/or fees
owed prior to the incorporation. The liability of the individual owner(s) for the subsequent liabilities of the new entity would be subject to the CDTFA’s rules as set forth in RTC section 6829 or RTC section 6071.1 (a) and (b).

**Conversions - Administrative Fees for Cigarette Licensees**

Under the Cigarette and Tobacco Licensing Act of 2003, cigarette manufacturers and importers are required to pay an administrative fee when they begin operations in the state. In cases where a corporation undergoes a conversion, the entity would not be required to pay an administrative fee. Conversely, if a sole proprietor incorporated, or formed an LLC or other form of business entity, the resulting corporation or other form of entity would be required to obtain a new Cigarette and Tobacco Products License and pay an administrative fee when it begins operations in this state.

**BILLING REQUESTS FOR STATUTORY MERGERS AND CONVERSIONS**

To request a demand billing to a merged or converted entity, a memorandum should be sent to CSB. The request **must** indicate the status (final or non-final) of the underlying liability. An open petition or appeal of one or more of the disappearing entities must be respected. In such case, rather than issue a demand billing, CSB will send the new entity a Statement of Account with specific bill notes and notify the Petitions Section who will add or substitute the surviving entity in place of the disappearing entity during the petition or appeal process.

Along with the status of the underlying liability, the request should include all pertinent information such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation, and information sources, etc. Any other evidence, such as written statements or documents, should also be forwarded.

**DE FACTO MERGERS**

A more difficult issue arises when one entity has effectively shut down without formally dissolving, and the owner has formed a new entity, doing the same business in the same location. There is no formal merger and no contract of sale that would support a successor liability billing. If the facts have been sufficiently investigated and certain conditions are present, the CDTFA may be able to assert that there has been a “de facto” merger and that the new entity should be billed as a “mere continuation” of the former entity. The following elements must be present to determine that there has been a de facto merger:

**Elements of a De Facto Merger**

1. Transfer of substantially all of the business assets of the former entity to the new entity,
2. Substantial alignment of ownership and/or control of the new and old entities (are the owners and managers of both entities substantially similar?),
3. Absence of meaningful consideration paid by the new entity for the assets of the former entity,
4. Evidence that the new entity is merely continuing the business of the former entity, such as: using a substantially similar business name, using the same business location, maintaining the same vendor accounts who supply to the new entity, using the same phone number, and having the same employees, and
5. The absence of evidence that the former entity formally dissolved, filed appropriate documentation with SOS and wrapped up its affairs. Before taking steps such as registration of registering the new entity under a de facto merger theory, or submitting billing requests for the new entity, a dual determination under RTC section 6829 must have been explored. The CDTFA may not issue a de facto billing until after a dual determination under RTC section 6829 has been issued, or until after the CDTFA has determined that the requisite elements for a section 6829 dual determination are not present.

**Registration for De Facto Mergers**

In this type of situation, CDTFA staff should close out the account(s) of the shut-down entity and issue a new account(s) for the new entity. If the new entity is not willing to self-register, an arbitrary permit number can be issued in order to complete the registration. The registration activities should be performed based on the results of the CDTFA investigation activities. In this situation, the account(s) of the terminated entity should be closed and a new account(s) issued for the new entity. If the new entity is not willing to self-register, an account can be issued to complete the registration (see CPPM section 295.090). Registration should be performed based on the results of CDTFA investigation.

**Billing Requests for De Facto Mergers**

A demand billing for a liability that is final can be issued to the surviving entity for payment of the liability incurred by the former entity. As with all requests for demand billings, the request must state the status of the underlying liability can be issued to the surviving entity for payment of the liability incurred by the former entity. The request must state the status of the existing liability. An open petition or appeal of one or more of the disappearing entities must be respected. In such case, rather than issue a demand billing, CSB will send the new entity a Statement of Account with specific bill notes and notify the Petitions Section who will add or substitute the surviving entity in place of the disappearing entity during the petition or appeal process.

The request must include all pertinent information such as the names and account numbers of the former and succeeding entities, amount(s) and periods of liability, documentation and information sources, etc. However, in order to pursue a de facto merger, all five elements of a de facto merger must also be present and clearly documented in the request. Send requests for demand billings to CSB who will consult with the Litigation Bureau before the request is approved.

**Statute of Limitations for Mergers and Conversions**

There is no specific statute that limits a conversion, merger, or de facto merger billing of a secondary entity for the liability of a primary entity. The doctrine of laches may apply in these cases where there is no statute. The doctrine affords a taxpayer an equitable defense if the CDTFA’s billing was unreasonably delayed. Therefore, the CDTFA’s policy is to issue the conversion, merger, or de facto merger billing within three years of acquiring knowledge of the facts supporting the secondary billing.

**ACQUISITIONS**

Acquisitions are a form of reorganization, and are covered in subdivisions (b) and (c) of section 181 of the CCC. Persons or entities can make acquisitions of all the forms of business entities discussed previously in the Overview part of this section. It is
important to distinguish between a situation involving the acquisition of the equity securities of an entity, such as shares of stock of a corporation, a partnership interest of a general partnership, or membership interests of an LLC (also known as an “exchange reorganization”), and the acquisition of the assets of an entity (a “sale-of-assets reorganization”). The two types of acquisitions are described below.

**Acquisition of Equity Securities / Exchange Reorganization**

When one person or entity acquires some or all of an entity’s equity securities from others, the form of the entity remains intact, and only the shareholders or owners have changed. The entity has been acquired by new owners, in whole or in part, but retains its identity. If it holds accounts(s) with the CDTFA, the account(s) should continue with the same name. The acquisition of an entity through exchange reorganization does not trigger successor liability. The sale of equity securities of an entity, including membership interests of an LLC, is not a transfer of ownership of physical assets for a financial consideration. Any liability of the entity that existed before the exchange reorganization remains a liability after such a transaction. There is no “disappearing entity” and no “surviving entity,” therefore, there is no billing.

**Registration for Acquisition of Equity Securities**

In this type of situation, the entity continues to exist. It is not necessary to close out the account(s) of the entity and issue new account(s) in this case since the entity continues to exist. Depending on the responsibility of the person acquiring the equity securities, the names of the persons acquiring the interest in the entity (such as partnership shares in a general partnership or a new CEO of a corporation) may need to be added to the account in the same manner as if such purchaser was one of the owners at the time the entity was originally registered as provided in Chapter 2 of this CPPM.

**Registration for Assets/Sale-of-Assets Reorganization**

Staff must determine if the entity whose assets were acquired has actually closed. All locations of the “selling” entity must be closed before closing out its account(s). Staff members must determine if the entity whose assets were acquired has ceased operating. All locations of the “selling” entity must be closed before closing out its account(s). Team members should issue new account(s) to the entity that acquired the assets.

**Billing Requests When There is an Acquisition**

If the elements of a successor liability are present, the acquiring entity can be billed as a successor. See CPPM section 732.000 for more information.
NOTIFICATION OF REGISTRATION CHANGES

Information concerning updates to registration due to mergers, acquisitions or conversions may come from the tax or fee payer through written correspondence, investigation, or communication by telephone or e-mail with the account holder or its representative. Regardless of whether a liability exists, upon notification of a merger, acquisition or conversion, staff receiving the information should verify the status of the old and new entities via the “Business Search” function available on the Secretary of State’s (SOS) website located at http://kepler.sos.ca.gov.

Since the entity may be registered for multiple programs with the CDTFA, staff making the discovery of the merger, acquisition or conversion, should check for other related accounts in IRIS. In the event staff discover other CDTFA accounts that are affected by the merger, acquisition or conversion but the accounts/programs are not under their jurisdiction (based on tax or fee program), they should prepare a memo for their Compliance Principal (or equivalent for special taxes and fees programs) containing the following elements:

1. CDTFA account number(s) and TIN affected.
2. SOS number (existing if applicable and new) affected by change.
3. Type of change (merger, de facto merger, conversion, sole proprietor to corporate change, acquisition of equity securities, acquisition of assets).
4. Effective date of change.
5. Action taken on CDTFA account(s) administered by discovering jurisdiction.
6. New CDTFA account number(s) and TIN established, if applicable.

The Compliance Principal (or equivalent for special taxes and fees programs) overseeing the area that discovered the merger, acquisition, or conversion should forward the aforementioned information and documents used to verify the information to the Compliance Principal (or equivalent for special taxes and fees programs) responsible for overseeing registration activities outside their jurisdiction (based on tax or fee program) requiring potential account updates.

JEOPARDY DETERMINATIONS

If staff determines the facts showing that the secondary entity is concealing or otherwise disposing of its assets, the CDTFA could issue a jeopardy determination, which would have the effect of rendering that entity’s liability final (see CPPM section 764.020 for information on jeopardy determinations). The mere creation of the secondary entity and the cessation of business by the primary entity, however, do not alone justify use of a jeopardy determination. A jeopardy determination is reserved for those cases where
assets are truly in danger of being immediately hidden, moved, or otherwise disposed of. If a team member discovers that the secondary entity is concealing or otherwise disposing of its assets, a jeopardy determination may be issued, rendering that entity’s liability as final (see CPPM section 764.020 for information on jeopardy determinations). The mere creation of the secondary entity and the cessation of business by the primary entity, however, does not in itself justify a jeopardy determination. A jeopardy determination is used for those cases where assets are truly in danger of being immediately hidden, moved, or otherwise disposed of.