

**MAR 16 2007**

**ORDERED PUBLISHED**

**HAROLD S. MARENUS, CLERK  
U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT**

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT**

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In re:	)	BAP No.	CC-06-1207-MoDK
	)		
ERNEST LEAL and MARIA LEAL	)	Bk. No.	LA 04-31307 EC
	)		
Debtors.	)		
_____	)		
STATE BOARD OF EQUALIZATION,	)		
an agency of the State of	)		
California,	)		
	)		
Appellant,	)		
	)		
v.	)	<b><u>OPINION</u></b>	
	)		
ERNEST LEAL; MARIA LEAL,	)		
	)		
Appellees.	)		
_____	)		

Argued and Submitted on February 22, 2007  
at Pasadena, California

Filed - March 16, 2007

Appeal from the United States Bankruptcy Court  
for the Central District of California

Hon. Ellen Carroll, Bankruptcy Judge, Presiding.

\_\_\_\_\_  
Before: MONTALI, DUNN and KLEIN, Bankruptcy Judges.

1 MONTALI, Bankruptcy Judge:

2

3       The bankruptcy court ruled that debtors Ernest and Maria Leal  
4 ("Debtors") have no personal liability for unpaid sales taxes from  
5 a retail shoe business, even assuming that they were partners in  
6 the business, because there was no evidence that they were  
7 responsible for or willfully failed to pay the sales taxes. We  
8 hold that nothing in Cal. Rev. & Tax Code section 6829<sup>1</sup> operates  
9 as a shield against the joint and several liability of general  
10 partners. Accordingly, we REVERSE and REMAND.

11

### I. FACTS

12       In 2002 Debtors were approached by long time acquaintances  
13 (the "Stanleys") regarding an investment opportunity in a new  
14 retail shoe store located at Rancho Mirage, California. Debtors  
15 were asked to provide what they characterize as a  
16 "loan/investment" to be repaid from future profits generated by  
17 the business. The Stanleys promised that all operational and  
18 business management would be handled by Mr. Stanley, who had  
19 experience managing retail shoe businesses. The store opened  
20 around October of 2002 and was known as Desert Shoes.

21       Each of the Debtors and the Stanleys signed a lease  
22 identifying all of them collectively as the tenant doing business  
23 under the trade name of Desert Shoes. Debtor Maria Leal and Ms.

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25       <sup>1</sup> We refer to the California Revenue and Taxation Code as  
26 the "Cal. Rev. & Tax Code" and the California Corporations Code as  
27 the "Cal. Corp. Code." The term "Chapter 7" refers to Chapter 7  
28 of the Bankruptcy Code, 11 U.S.C. §§ 101-1328 (prior to amendment  
by The Bankruptcy Abuse Prevention and Consumer Protection Act of  
2005, Pub. L. 109-8, 119 Stat. 23, because the case from which  
this appeal arises was filed before its effective date, which is  
generally October 17, 2005).

1 Stanley signed a Business License Tax Application that was filed  
2 with the City of Rancho Mirage. Next to Debtor Maria Leal's  
3 signature in what appears to be her handwriting is the word, "co-  
4 owner."

5 Debtor Maria Leal alleges that she visited the Desert Shoes  
6 store approximately three times after it opened and that Debtors  
7 "invested/loaned over \$50,000.00 in capital and credit for the  
8 benefit of the Stanleys" but that Debtors never were involved in  
9 any operational aspects of the business and signed no checks from  
10 its accounts. Several months after the store opened the Stanleys  
11 started avoiding contact with Debtors. Debtors eventually were  
12 told by Mr. Stanley that he had closed the store because its lease  
13 was in default.

14 Meanwhile, some creditors of Desert Shoes brought actions  
15 against Debtor Maria Leal as a partner of or d/b/a Desert Shoes.  
16 At least one default judgment was entered against her.

17 Debtors filed their voluntary Chapter 7 petition on October  
18 6, 2004 (the "Petition Date"). Their bankruptcy Schedule E states  
19 that they have no priority debts. They do not list the State  
20 Board of Equalization, an agency of the State of California (the  
21 "SBE"), among their creditors. Nevertheless, most of their debts  
22 appear to be business debts related to Desert Shoes, their  
23 bankruptcy Schedule G lists the Desert Shoes lease, and their  
24 Statement of Financial Affairs, item 18, lists Desert Shoes as a  
25 business "in which the debtor was an officer, director, partner,  
26 or managing executive." Debtors received their discharge and  
27 their bankruptcy case was closed.

28 Thereafter Debtors began to receive correspondence and

1 telephone calls from the SBE regarding Desert Shoes' unpaid sales  
2 taxes in the amount of approximately \$20,000. The SBE alleges  
3 that in the course of its calls with Debtor Maria Leal she  
4 admitted that she was a "silent partner" in Desert Shoes.

5 Debtors filed a motion to reopen their Chapter 7 case, which  
6 the bankruptcy court granted, and a motion to determine the  
7 validity of the alleged sales tax debts and tax liens against  
8 them, which the SBE opposed. The latter motion came on for  
9 hearing on May 31, 2006.

10 The SBE argued that both Debtors were in a general  
11 partnership with the Stanleys and as such they have joint and  
12 several liability for sales taxes. The SBE sought an evidentiary  
13 hearing on whether or not a partnership existed. The bankruptcy  
14 court assumed for the sake of discussion that there was a  
15 partnership but ruled that under Cal. Rev. & Tax Code section 6829  
16 "the person that you want to have be responsible for these taxes  
17 has to have control or supervision or be charged with  
18 responsibility for filing tax returns and paying taxes" and must  
19 have "willfully failed to pay the taxes," and there was  
20 "absolutely no evidence" of either of these things. Transcript,  
21 May 31, 2006, p. 15:3-11. The bankruptcy court granted Debtors'  
22 motion to determine tax liability and ordered that any assessments  
23 for taxes, interest, and penalties for "all tax periods commencing  
24 March 1, 2002, through May 31, 2006,<sup>[2]</sup> inclusive, shall be

25 \_\_\_\_\_  
26 <sup>2</sup> This time period extends beyond the Petition Date, but it  
27 appears that no shoes were being sold after that date. In any  
28 event, based upon our questions at oral argument no party appears  
to assert that the bankruptcy court's jurisdiction under 11 U.S.C.  
(continued...)

1 expunged and disallowed in its entirety.” The bankruptcy court  
2 also directed the SBE to “cause to release or withdraw any tax  
3 lien filed against the Debtors for [Desert Shoes’] tax debts” to  
4 the SBE incurred during the same period. The SBE filed a timely  
5 notice of appeal.

## 6 **II. ISSUE**

7 Does Cal. Rev. & Tax Code section 6829 shield debtors from  
8 whatever joint and several liability they may have as general  
9 partners with the Stanleys in the Desert Shoes business?

## 10 **III. STANDARD OF REVIEW**

11 We review the bankruptcy court’s interpretation of state law  
12 de novo. Conestoga Servs. Corp. v. Exec. Risk Indem., Inc., 312  
13 F.3d 976, 981 (9th Cir. 2002).

## 14 **IV. DISCUSSION**

15 Most tax claims are nondischargeable in bankruptcy. See 11  
16 U.S.C. §§ 523(a)(1) and 507(a)(8). Debtors argue that they have  
17 no sales tax liability at all.

18 We assume without deciding that neither Debtor had  
19 responsibility for paying sales taxes or any other involvement in  
20 operating the Desert Shoes business. That is not enough to excuse  
21 one or both of them from joint and several liability for the  
22 nonpayment of sales taxes, if in fact one or both are liable as  
23 general partners. Under the Revised Uniform Partnership Act as  
24 enacted in California, “all partners are liable jointly and  
25 severally for all obligations of the partnership unless otherwise

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26  
27 <sup>2</sup>(...continued)  
28 § 505 or otherwise would extend to post-petition sales in this  
Chapter 7 case. We assume without deciding that it does not.

1 agreed by the claimant or provided by law." Cal. Corp. Code  
2 § 16306(a). See also Young v. Riddell, 283 F.2d 909, 910 (9th  
3 Cir. 1960) (even secret or dormant partner was still subject to  
4 joint and several liability, including for tax debts of bankrupt  
5 partnership).

6 There are some exceptions within Cal. Corp. Code section  
7 16306(a) itself. Partners are not liable for obligations incurred  
8 before their admission as a partner, and partners in a limited  
9 partnership are not personally liable for the limited  
10 partnership's debts. Cal. Corp. Code § 16306(b), (c). Debtors  
11 argue that there is another exception for any sales tax liability,  
12 established by Cal. Rev. & Tax Code section 6829. That section  
13 provides in relevant part:

14 (a) Notwithstanding Section 16306, 16307, 17101,  
15 17158, 17355, 17450, or 17456 of the Corporations Code,  
16 upon termination, dissolution, or abandonment of a  
17 partnership, a registered or foreign limited liability  
18 partnership or a domestic or foreign corporate or  
19 limited liability company business, any officer, member,  
20 manager, partner, or other person having control or  
21 supervision of, or who is charged with the  
22 responsibility for the filing of returns or the payment  
23 of tax, or who is under a duty to act for the  
24 corporation, partnership, limited liability partnership,  
25 or limited liability company in complying with any  
26 requirement of this part, shall be personally liable  
27 for any unpaid taxes and interest and penalties on those  
28 taxes, if the officer, member, manager, or other person  
willfully fails to pay or to cause to be paid any taxes  
due from the corporation, partnership, limited liability  
partnership, or limited liability company pursuant to  
this part.

24 Cal. Rev. & Tax Code § 6829(a) (emphasis added).

25 The bankruptcy court agreed with Debtors. It read the  
26 introductory clause in the above quote -- "[n]otwithstanding  
27 Section 16306 . . . of the Corporations Code" -- to mean that Cal.  
28 Rev. & Tax Code section 6829 supplants Cal. Corp. Code section

1 16306 on the issue of sales tax liability. We disagree.

2 As Debtors' counsel conceded at oral argument before us,  
3 "notwithstanding" generally means "despite." Cal. Rev. & Tax Code  
4 section 6829 provides for liability despite various statutes that  
5 would otherwise exonerate a person from liability. This makes  
6 sense. Persons who are responsible for filing returns or paying  
7 sales taxes are liable if they willfully fail to remit sales taxes  
8 to the SBE, notwithstanding that some persons such as limited  
9 partners are not liable for most partnership debts under Cal.  
10 Corp. Code section 16306.<sup>3</sup>

11 The same reasoning applies to the other statutes listed in  
12 the "notwithstanding" clause of Cal. Rev. & Tax Code section 6829.  
13 All of those statutes include potential protections from  
14 liability. See, e.g., Cal. Corp. Code § 17101(a) (in general, "no  
15 member of a limited liability company shall be personally liable  
16 under any judgment of a court, or in any other manner, for any

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18 <sup>3</sup> The relevant provisions of Cal. Corp. Code section 16306  
state:

19 (b) A person admitted as a partner into an existing  
20 partnership is not personally liable for any partnership  
21 obligation incurred before the person's admission as a  
partner.

22 (c) Notwithstanding any other section of this chapter, and  
23 subject to subdivisions (d), (e), (f), and (h), a partner in  
24 a registered limited liability partnership is not liable or  
25 accountable, directly or indirectly, including by way of  
26 indemnification, contribution, assessment, or otherwise, for  
27 debts, obligations, or liabilities of or chargeable to the  
partnership or another partner in the partnership, whether  
arising in tort, contract, or otherwise, that are incurred,  
created, or assumed by the partnership while the partnership  
is a registered limited liability partnership, by reason of  
being a partner or acting in the conduct of the business or  
activities of the partnership.

28 Cal. Corp. Code § 16306(b) and (c).

1 debt, obligation, or liability of the limited liability company").  
2 Notwithstanding such protections, section 6829 imposes liability  
3 on persons who are responsible for sales taxes but willfully fail  
4 to remit those taxes to the SBE.<sup>4</sup>

5 We conclude that Cal. Rev. & Tax Code section 6829 does not  
6 protect Debtors from any liability they may have as general  
7 partners under Cal. Corp. Code section 16306(a). The bankruptcy  
8 court should have granted the SBE's request for an evidentiary  
9 hearing to determine whether Debtors were general partners in  
10 Desert Shoes.

11 Our conclusion is supported by the existence of Cal. Rev. &  
12 Tax Code section 6487.2(b), which protects general partners from  
13 personal liability after expiration of a limitations period.<sup>5</sup> The

14 \_\_\_\_\_  
15 <sup>4</sup> See also Cal. Corp. Code § 16307(b) and (c) (creditor of a  
16 partnership generally cannot collect from a partner without first  
17 obtaining a judgment against the partnership and levying against  
18 partnership property); Cal. Corp. Code § 17158(a) (in general,  
19 "[n]o person who is a manager or officer or both a manager and  
20 officer of a limited liability company shall be personally liable  
21 under any judgment of a court, or in any other manner, for any  
22 debt, obligation, or liability of the limited liability company");  
23 Cal. Corp. Code § 17355(a)(1)(B) ("Causes of action against a  
24 dissolved limited liability company" generally may be enforced  
25 against "members of the dissolved limited liability company" but  
26 only "to the extent of the limited liability company assets  
27 distributed to them upon dissolution of the limited liability  
28 company."); Cal. Corp. Code § 17450(a) ("The laws of the state or  
foreign country under which a foreign limited liability company is  
organized shall govern its organization and internal affairs and  
the liability and authority of its managers and members."); and  
Cal. Corp. Code § 17456(c) ("A member of a foreign limited  
liability company is not liable for the debts and obligations of  
the foreign limited liability company solely by reason of its  
having transacted business in this state without registration.").

26 <sup>5</sup> The statute provides, with inapplicable exceptions:

27 (b) An individual who was a general partner, as shown on  
28 the board's records, who withdraws from a partnership without  
(continued...)



1 statute of limitations itself is irrelevant to this appeal --  
2 nobody argues that it is a defense -- but there would be no need  
3 for the California legislature to enact a statute of limitations  
4 directed specifically to protecting general partners from sales  
5 tax liability if, as Debtors argue, general partners were not  
6 liable for unpaid sales taxes in the first place.

7 Another aspect of the statutory scheme also supports our  
8 analysis. In general a creditor of a partnership cannot collect  
9 from a partner without first obtaining a judgment against the  
10 partnership and levying against partnership property. See Cal.  
11 Corp. Code § 16307(c) and (d). The SBE is granted an exception to  
12 that rule in some circumstances. See Cal. Rev. & Tax Code § 6831  
13 ("The [SBE] shall not be subject to subdivisions (c) and (d) of  
14 Section 16307 of the Corporations Code unless, at the time of  
15 application for a seller's permit, the applicant furnishes to the  
16 board a written partnership agreement that provides that all  
17 business assets shall be held in the name of the partnership.").  
18 There would be no point in providing this limited exception to  
19 liability if, as Debtors argue, general partners were already  
20 protected from liability by Cal. Rev. & Tax Code section 6829.

21 We see no ambiguity in the statutory scheme described above,  
22 but even if there were some ambiguity the SBE cites legislative  
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24 <sup>5</sup> (...continued)  
25 notifying the board of the change in ownership, shall not be  
26 liable for any unpaid, self-assessed liability of the  
27 partnership that becomes due at least three years after the  
last day of the calendar month following the quarterly period  
in which the change in ownership occurred.

28 Cal. Rev. & Tax Code § 6487.2(b).

1 history that supports our analysis. When the California  
2 legislature was considering adoption of the Revised Uniform  
3 Partnership Act the SBE asked that the bill be amended to add Cal.  
4 Rev. & Tax Code section 6831 and thereby preserve its existing  
5 rights to collect from partners directly:

6           The [SBE] argues that existing law allows a tax  
7 agency like the [SBE] to immediately pursue not only the  
8 partnership's assets, but also the assets of each  
9 partner to settle an outstanding debt. Under this bill  
10 [to adopt the Revised Uniform Partnership Act], it would  
11 require all collection remedies against a partnership to  
12 be exhausted before collection actions could be taken  
13 against any partners. This bill would cause an increase  
14 in the cost of collections and delays in collecting a  
15 partner's debts.

16           The [SBE] requests an amendment to allow it to  
17 continue the current collection practices on partners  
18 and partnerships.

19 Senate Jud. Comm. Analysis, A.B. 583, July 2, 1996 (1995-96 Reg.  
20 Sess.), pp. 10-11.

21           The California legislature was persuaded. The bill was  
22 amended to add Cal. Rev. & Tax Code section 6831 to "allow the  
23 [SBE] to continue the current tax collection practices on partners  
24 and partnerships." Senate Rules Comm. Analysis, A.B. 583, August  
25 23, 1996 (1995-96 Reg. Sess.), p. 3, ¶ 6.

26           Finally, courts interpreting other states' partnership  
27 statutes have held that a partner is liable for the partnership's  
28 unpaid taxes even though the partner was not personally  
responsible for paying those taxes. See Livingston v. United  
States, 793 F. Supp. 251, 254 (D. Idaho 1992) (applying Idaho law,  
and rejecting argument similar to Debtors' argument in this case);  
In re Norton, 158 B.R. 834 (Bankr. D. Idaho 1993) (applying Utah  
law and following Livingston).

1 For all of these reasons we reject Debtors' attempt to use  
2 Cal. Rev. & Tax Code section 6829 as a shield from liability.  
3 That statute was intended to give the SBE another tool to collect  
4 sales taxes from persons responsible for such collection, not to  
5 protect partners from any joint and several liability they would  
6 otherwise have.

7 **V. CONCLUSION**

8 We express no opinion whether either Debtor actually was a  
9 general partner in Desert Shoes. The bankruptcy court can address  
10 that issue on remand. We simply hold that Debtors cannot use Cal.  
11 Rev. & Tax Code section 6829 as a shield against liability if in  
12 fact they are general partners. Accordingly, the bankruptcy  
13 court's order granting Debtors' motion to determine tax liability  
14 is REVERSED and the matter is REMANDED.

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