

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Claim )  
 for Refund Under the Sales ) DECISION AND RECOMMENDATION  
 and Use Tax Law of: )  
 )  
 T--- M--- M---, INC. ) No. SR DH XX XXXXXX-001  
 )  
 )  
 )  
Claimant )

The Appeals conference in the above-referenced matter was held by Staff Counsel Lucian Khan on May 10, 1994 in Fresno, California.

Appearing for T--- M---  
M---, Inc.:

J--- T---  
President

Appearing for G--- I---  
S--- Co. (real party in  
interest):

D--- H---  
President

J--- P---  
Attorney at Law

Appearing for the  
Sales and Use Tax Department:

Richard Martin  
District Principal Compliance  
Supervisor

Bud Jones  
District Principal Auditor

Carmelyne Crutchfield  
Senior Tax Representative

Subject of Claim

The amount of \$32,114.25 remitted to the Board on May 21, 1993 as a result of a levy on the bank account of T--- M--- M---

### Contention

G--- I--- S--- Co. (G---) is entitled to return of the funds based on its perfected security interest in T--- M--- M---, Inc.'s (T---'s) receivables and proceeds from the sale of inventory.

### Summary

On April 1, 1991, T--- signed a promissory note in the amount of \$125,000 in which it agreed to pay interest at the rate of 12 percent per annum, and principal payments of \$6,500 per month, to G---. The due date of any remaining principal and interest was December 31, 1991. On December 13, 1991, T--- executed a security agreement with G---, granting G--- a security interest in various assets of T---, including inventory, proceeds from the sale of inventory, and receivables. On January 6, 1992, G--- perfected its security interest by filing a financing statement with the Secretary of State pursuant to California Uniform Commercial Code Section 9403. Sometime in 1992 (date unknown), an undated extension agreement was executed by both T--- and G---, further extending the due date on the \$125,000 note from December 31, 1991 to December 31, 1992.

On May 18, 1993, the Compliance Section of the Sales and Use Tax Department (SUTD) levied T---'s bank account, and on May 21, 1993, received funds in the amount of \$32,114.25. The funds were applied to amounts T--- owed to the Board, which was the result of filing no remittance returns, and Board-issued determinations for various quarters in late 1990 through 1992. No liens were ever filed.

G--- argues, that because it had a perfected security interest in T---'s inventory, as well as the proceeds from the sale of that inventory, the Board may not retain the funds recovered. In support of this argument, G--- has furnished copies of T---'s bank statements and deposit slips for April and May of 1993, invoices from T--- which relate to deposits shown on the bank statements, the original promissory note dated April 1, 1991, the security agreement of December 13, 1991, the January 6, 1992 financing statement filed with the Secretary of State, the undated extension agreement for the April 1, 1991 promissory note, and various checks each in the amount of \$1,250 (as evidence that the balance to G--- is still owing).

On behalf of SUTD, Staff Counsel Thomas Cooke in a June 23, 1994 memo concludes that on the date of the levy, the records submitted indicate that at least \$32,114.25 in T---'s bank account is attributable to the proceeds from the sale of inventory within the ruling of the case, Chrysler Credit Corporation v. Superior Court (1993) 17 Cal.App.4th 1303. In that case, the court applied the "lowest intermediate balance rule", which provides:

“When proceeds of a sale of collateral are placed in the debtor's bank account the proceeds remain identifiable and a security interest in the funds continues even if the funds are commingled with other funds.... [P]roceeds of the sale of collateral remain in the account as long as the account balance equals or exceeds the amount of the proceeds. The funds are `identified' based on the assumption that the debtor spends his own money out of the account before he spends the funds encumbered by the security interest. If the amount balance drops below the amount of the proceeds, the security interest in the funds on deposit abates accordingly. This lower balance is not increased if funds are later deposited into the account.” (17 Cal.App.4th at 1315-1316.)

In applying this rule, Mr. Cooke determined from a review of the bank statements and various invoices submitted that the lowest daily balance in the account occurred on May 5, 1993 when the balance was \$20,199.99. The full \$20,199.99 balance on that date was subject to the security interest of G--- since it was traceable to the sale of inventory. After May 5, 1993, the balance in the account never fell below the sum levied (\$32,114.25) before the date of the levy. Deposits on May 7, 1993 were traced to two additional invoices amounting to \$9,491.63 and \$6,709.60; thus, on the date of the levy, the \$32,114.25 in T---'s bank account has been proven as attributable to proceeds of the sale of inventory.

#### Analysis and Conclusions

In determining whether the claim for refund should be granted, the following issues must be resolved:

1. Has it been sufficiently proven that T--- still owes G--- for the previously executed promissory note?
2. If so, did G--- acquire priority over the Board because of its security interest in T---'s inventory and proceeds from the sale of inventory?
3. Has G--- adequately met its burden to show that the funds attached by the Board's levy are in fact identifiable proceeds from inventory sales?

As to the first issue, I conclude that G--- has submitted adequate proof that the initial \$125,000 balance from T--- is still due and owing. This is evidenced by the various copies of the monthly interest checks or check stubs, each in the amount of \$1,250. The promissory note provides for an interest rate of 12 percent per annum (one percent per month). Thus, the checks represent interest payments. The last check is dated May 11, 1994.

I also conclude that G--- had a perfected security interest, giving it priority over the Board. A noted exception to Revenue and Taxation Code Section 6756, which would otherwise give the Board a preference over any other liens or security interests, is where that interest is recorded or perfected prior to the Board filing its lien. In order to perfect a security interest, one must file a financing statement (UCC § 9302(1)), which must be filed in most cases with the Office of the Secretary of State. (UCC § 9401(1)(a), (b), and (c).) Therefore, in order for the Board to have priority over G---'s perfected security interest, it must have filed a lien prior to the time the interest was perfected. Here, at least on the date the conference was held, a lien had not yet been filed.

Finally, we conclude that for the reasons stated in Mr. Cooke's June 23, 1994 memo, that on the date of the levy, at least \$32,114.25 in T---'s bank account would be attributable to the proceeds from the sale of inventory within the ruling of the Chrysler case. Therefore, G--- has met its burden of tracing the funds to show that they are in fact identifiable proceeds from the sale of inventory. Accordingly, the claim for refund should be granted; however, because Revenue and Taxation Code Section 6937 would prevent the Board from paying the refund to someone other than the person who paid the amount (T---), the refund must be made directly to T---.

Recommendation

Grant the claim for refund.

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Lucian Khan, Staff Counsel

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Date