



STATE BOARD OF EQUALIZATION

August 14, 1969

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Attention: Mr. ---

Gentlemen:

This is with reference to the petitions of ABC, Inc., and DEF, and the hearings held on the matters last July 17 in Hollywood.

In ABC, the measure included the sale of some equipment for \$2,400 which was not protested. It also included receipts from lease of equipment which the DEF people could not support as having been acquired tax paid, nor as having paid tax on the cost price.

A certificate of delinquency carries with it the presumption that the board's determination is correct. The taxpayer has the burden of proving not only that the determination, based upon his records, is incorrect, but also of producing evidence from which another and proper determination may be made. (People v. Schwartz, 31 Cal.3d 59 (1947).)

I recall that something was said at the hearing that the condition of the DEF's records at the time of the merger into ABC, Inc., left something to be desired. In any event, nothing was offered to support a recommendation that the measure be deleted or even reduced. Thus, as to the DEF petition, we are recommending that it be denied.

In the ABC, Inc., audit, there are three items which make up the measure of tax liability. The first is lease receipts not reported, and it relates to the lease of DEF equipment after the statutory merger.

The question, in part, turns on the status of tax-paid property after a statutory merger. It is well established that a statutory merger is not a sale. There is no transfer, as such, of assets, but by operation of law there is what might be called an absorption of the constituent or merged corporation. It follows that this does not operate to change the status of property from tax paid to ex tax. We agree that Mutual Building & Loan Association of Pasadena v. Wiborg, 59 Cal.app.3d 325 (1943) and Gallo Winery v. Commissioner, 227 F.2d 699, each support this conclusion.

Thus, as to item A, we are recommending that there be a reaudit and the tax be computed on the basis that there was no change in the status of the DEF property absorbed under the statutory merger.

Item B represents a measure of use tax for liability arising when rental inventory was withdrawn and used by the lessor. Obviously it would not arise if the inventory property was held in a tax paid status, and this might be the case in the light of the above conclusion regarding statutory mergers. At the same time, the property might have been that which your client could not support as having been acquired with payment of sales or use tax.

Thus, we are recommending that the measure of use tax be computed using a ration of tax paid and ex tax property in the absence of a showing that the property was tax paid.

Item C represents a credit for tax paid on the cost price of equipment purchased after the merger. Tax was reported and paid by persons formerly with DEF who remained with the business after the merger. We understand that this was done contrary to ABC policy. It was disallowed by the auditor because the payment was not timely, in that it was not paid with the returns due from the rentals when the property was first rented. We have enclosed a copy of ruling 70 which covers this point.

Thus, as to item C, we are of the opinion that the payment was properly disallowed. The credit will operate to reduce the measure of the tax; however, rental receipts from rentals of that property will always be subject to tax when held by ABC and rented in California.

As we see it, by reason of the fact that there was some liability on rentals made by DEF before the merger (1-1-63 to 12-9-65), there will no doubt be some liability under item A in the ABC, Inc., determination after the reaudit because the same property is involved. It will be small, since the ABC Inc., audit period is less than seven months. Depending on how much this comes to, the disallowed payment of tax on cost price (item C) may wipe out the liability in both DEF and ABC, Inc.

With respect to the penalty for failure to file returns which was discussed at the hearing, we again make reference to section 6592 of the Revenue and Taxation Code, as this is the only way relief can be had, if at all. We do not make recommendations on penalties where they have been asserted for failure to file returns. In your client's case the failure to file was somewhat unusual because if your client had been issued a permit to report on a quarterly basis, the first return would

have been timely. We do not attempt to second guess the people who issue the permits, although it is noted that the merged corporation reported on an annual basis, and ABC, Inc., reported monthly.

You will hear from the auditors after they have completed the reaudit and adjusted the tax measure in accordance with the above recommendations.

Very truly yours,

Robert H. Anderson
Tax Counsel