M e m o r a n d u m

495.0713

To: Mr. --- -. [K]
Supervising Deputy Attorney General
Business and Tax Section
Department of Justice
1515 K Street, Suite 511
P. O. Box 944255
Sacramento, CA 94244-2550

Date: January 21, 1993

From: Gary J. Jugum
Assistant Chief Counsel

Subject: [G] v. State Board of Equalization
Sacramento Superior Court Case No. --XXXXXX
Third Appelate District No. -XXXXXX
Account No. S- -- XX-XXXXXX

This is in response to your memorandum of January 13, 1993. Please ask the Court of Appeal to publish its decision.

Rule 976 provides for publication of an opinion which "involves a legal issue of continuing public interest."

Regretfully, not everyone shares the Court's understanding of "standard Hornbrook Law." We should petition the Court to publish its decision in the interests of judicial economy. The state Board of Equalization administers the Sales and Use Tax Law. Quite frequently, an audit assessment is made. in circumstances identical to those considered by the Court in the referenced case. There is a great deal of uncertainty in the minds of taxpayers and general tax practitioners as to how the tax applies in these circumstances. This leads to misreporting of the tax and wasteful administrative proceedings at this agency. In addition, there are presently pending in other appellate districts, two cases involving facts similar to those in this case. We believe it would facilitate resolution of these other matters if the court would publish its decision. I am sure you can phrase all of this much better, but this really is an appropriate case for publication.

GJJ:sr

cc: Ms. --- [S]
Deputy Attorney General – [city]

Ms. --- --- [S]
Deputy Attorney General – [city]

Mr. Robert Nunes
Mr. Glenn A. Bystrom
Mr. E. L. Sorensen, Jr.
Mr. Donald J. Hennessy
Mr. Stephen A. Ryan
Mr. David H. Levine
Ms. Elizabeth Abreu
Litigation File: General

M e m o r a n d u m

495.0713

To: E. Leslie Sorensen, Jr., Chief Counsel
State Board of Equalization
1020 N Street
Sacramento, California 95814

Date: January 13, 1993

From: --- -. [K]
Supervising Deputy Attorney General
Business and Tax Section

Subject: [*G], et al. v. SBE*
Third Appellate District No. -XXXXXX

Enclosed is a copy of the unpublished Court of Appeal opinion received this date. Since the lower court's judgment in our favor was affirmed on appeal, there is nothing to be done at this point except to consider whether we wish to attempt to get the opinion published. Please get back to me on this issue. I will keep you informed of any further developments at my end. I will be handling the matter.

LKK:mlk

Encl.

cc: Gary Jugum, Asst. Chief Counsel (w/encl.)
SBE

David H. Levine (w/o encl.)

NOT FOR PUBLICATION

COPY

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Sacramento)

[G] CORPORATION et al., Plaintiffs and Appellants, v. STATE BOARD OF EQUALIZATION Defendant and Respondent	-XXXXXX (Super.Ct.No. --XXXXXX)

Plaintiffs [G] --- ([G]) and [U] sought a refund of state sales taxes. (Rev. & Tax. Code, § 6933.) Unsuccessful in their efforts, plaintiffs appeal from the trial court's judgment in favor of defendant State Board of Equalization (SBE). The question on appeal is whether the court erred in characterizing a transfer of assets as a taxable sale. We conclude that it did not and shall affirm the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

At trial, the parties stipulated to the following: [G] is a large corporation with many distinct, unincorporated divisions, each manufacturing and selling different products. One of these divisions was [A] Division (Division), which manufactured photolithography equipment.

In April 1984, [G] transferred the assets of Division to its wholly owned, newly created corporation, [U], Inc. ([U]) in exchange for the assumption by [U] of all of Division's liabilities.

The sole reason for [U]'s incorporation was to "create a subsidiary to whom [G] could transfer the assets of its [A] Division." Under this agreement, tangible personal property valued at $1,239,412 was transferred from Division to [U]. [U] assumed and agreed to pay all of the debts and liabilities of Division and subsequently made these payments. [G] officers were elected to [U]'s board of directors, and [U] continued to operate in the same location and in the same business as did Division before the transfer.

SBE conducted an audit and concluded sales tax of $80,561.78 and interest of $28,959 were due for this transaction.[1] Plaintiffs paid this assessment under protest. After SBE denied their claim for refund plaintiffs filed suit in superior court. The trial court ruled the transfer from [G] to a commencing corporation, [U], was a taxable event as defined by statutes and regulations and entered judgment in favor of SBE.[2] This appeal followed.

DISCUSSION

Plaintiffs assert they are entitled to a refund of state sales tax because no sale occurred. Specifically, they claim this transaction cannot be deemed a sale because it was not supported by adequate consideration. We disagree. "In a suit for tax refund, the burden of proof is on the taxpayer, not only to demonstrate [SBE's] determination is incorrect, but also to produce evidence from which a proper tax determination can be made. The taxpayer must affirmatively establish the right to a refund of the taxes by a preponderance of the evidence, and cannot simply assert error and shift to the state the burden of justifying the tax." (Paine v. State Bd. of Equalization (1982) 137 Cal.App.3d 438, 442, citations omitted.)

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1 SBE also assessed additional amounts for events unrelated to the matter on appeal.

2 "For sales tax purposes," it has been noted, "a parent corporation's ownership of the stock of a subsidiary does not, by itself, create an identity of corporate interest between the two. …Where the corporation and its subsidiary behave as separate entities the transfers between

Sales tax is imposed on retailers "[f]or the privilege of selling tangible personal property at retail."[3] (Rev. & Tax. Code, § 6051 [all further statutory references are to this code unless otherwise indicated].) Section 6006, subdivision (a) defines "sale" to include "[a]ny transfer of title or possession, exchange; or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration." The definition of consideration is found in Civil Code section 1605: "Any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise." In other words, adequate consideration consists of a benefit to the promisor or a detriment to the promisee.

Plaintiffs assert there was no valid consideration for the transfer of assets to justify characterizing this transaction as a sale. They offer a variety of theories to support this conclusion, most notably that [G] obtained no benefit from this transaction. We conclude otherwise.

Cal-Metal Corp. v. State Bd. of Equalization (1984) 161 Cal.App.3d 759, is instructive on the question. In that case, Cal-Metal and another company entered into a partnership agreement in which Cal-Metal transferred equipment to the partnership and the partnership agreed to assume liabilities on this equipment. SBE determined this transaction was a taxable sale and assessed sales tax and interest. Cal-Metal paid the tax under protest and filed a claim

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them which comply with the statutory definition of a sale are subject to sales tax." (Macrodyne Industries, Inc. v. State Ed. of Equalization (1987) 192 Cal.App.3d 579, 582, citations omitted.)

[3] As the Attorney General correctly notes, "[i]f a sale was made [in this case], it was a retail sale, and the [plaintiffs] have not argued otherwise. (See Rev. & Tax. Code, § 6007 [a retail sale is a sale for any purpose other than resale in the regular course of business].)"

for refund. The trial court granted SBE's motion for summary judgment and the Court of Appeal affirmed. (Id. at pp. 762-763.)

Reviewing the relevant sections of the Revenue and Taxation Code, the court noted "consideration need not be money, it may be any valuable consideration." (Cal-Metal Corp., supra, 161 Cal.App.3d at p. 764.) The court concluded the transaction was a taxable event as Cal-Metal transferred the title of the property to the partnership and the partnership assumed the liabilities on the equipment. "Such assumption of liabilities constituted valuable consideration." (Id. at p. 765.) This conclusion was reiterated several times: "Assuming this liability was most certainly a benefit to the taxpayer and constituted consideration for the transfer of the property," (id. at p. 766) and "The transfer of property resulted in the receipt by [Cal-Metal] of consideration in the form of assumption of its indebtedness." (Id. at p. 767.)

The court then turned to Sales and Use Tax regulation 1595, subdivision (b) (4) of title 18 of the California Code of Regulations. This regulation provides: "Tax does not apply to a transfer of property to a commencing corporation or commencing partnership in exchange solely for first issue stock of the commencing corporation or an interest in the commencing partnership. Tax does apply, however, if the transferor receives consideration such as cash, notes, or an assumption of indebtedness, and the transfer does not otherwise qualify for exemption. The tax is measured by the amount of such consideration attributable to the tangible personal property transferred." (Emphasis added.)

Speaking of this regulation, the Cal-Metal court held: "This regulation is directly applicable and specifically covers the taxpayer's transaction. …Under the code, this transaction constituted a sale because it was the transfer of property for consideration. Taxation of this transaction was appropriate." (161 Cal.App.3d at p. 768.)

We reach the same conclusion here. [G] transferred assets and liabilities to a newly formed corporation, [U]. [U] agreed to assume these liabilities and in fact made payments on these debts. In assuming these liabilities, [U] conferred a benefit upon [G], thus satisfying the consideration requirement. As the Attorney General accurately puts it, "[G] was not lawfully bound to transfer the assets to [U] Corporation, and [U] Corporation was not lawfully bound to assume the liabilities owned by [G]. Nevertheless, in exchange for [G]'s agreement to transfer tangible personal property to [U] Corporation, [U] Corporation agreed to assume (suffer) the liability (prejudice) that was owed only by [G]. That is, the transferee agreed to assume a liability which was not its own, and that clearly is consideration under standard Hornbook law."

In asserting otherwise, [G] relies on Macrodyne Industries, Inc. v. State Ed. of Equalization (1987) 192 Cal.App.3d 579. In that case, Macrodyne conducted business through four independent operating divisions. It entered into an agreement to transfer all of the assets and liabilities of three of these divisions to three of its preexisting wholly owned subsidiaries. However, the parties stipulated: "'Although the subsidiaries assumed the liabilities of the transferred divisions, Macrodyne remained jointly liable for the same liabilities after the subject transfers. '" (Id. at p. 581.)

SBE found the transfer of liabilities represented consideration to Macrodyne and concluded a taxable sale of assets had occurred. After paying the assessed sales tax, Macrodyne brought suit for refund, asserting that because it had received no consideration for the transaction, there had been no sale. The trial court agreed and the appellate court affirmed. (Macrodyne, supra, 192 Cal.App.3d at pp. 581-583.) "Macrodyne remains jointly liable for the liabilities of the transferred divisions despite the language of the contracts. Since the transfer of the divisions to the subsidiaries had no effect on the liability of Macrodyne, no benefit was

conferred upon Macrodyne by the transfer. There being no consideration, there could be no sale. Where there is no sale, no sales tax may be imposed." (Id. at p. 583.)

The court distinguished Cal-Metal, supra, 161 Cal.App.3d 759 from the case before it, noting the transferee in Cal-Metal was a commencing partnership and not a preexisting entity, thus involving regulation 1595, subdivision (b) (4). More importantly, the court noted, there was no stipulation in Cal-Metal that the transferor remained jointly liable. (Macrodyne, supra, 192 Cal.App.3d at p. 583.)

The same distinctions are apparent here. The transfer was not to a preexisting subsidiary, but to a newly created entity, and the provisions of title 18, California Code of Regulations, section 1595, subdivision (b) (4) apply: tax may be assessed because the transferor received consideration, namely the assumption of indebtedness. There was no agreement that [G] would remain jointly liable for the liabilities of the transferred divisions. Rather, the agreement specifically stated [U] would assume these liabilities, and in fact, [U] made payments on these debts.[4]

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[4] Plaintiffs suggest that Cal-Metal is inapplicable because the transfer in that case was to a commencing partnership rather than a commencing corporation. They assert this conclusion is compelled by the recent decision of Industrial Asphalt, Inc. v. state Bd. of Equalization (1992) 5 Cal.App.4th 1237. We disagree.

In Industrial Asphalt, two corporations formed a new partnership and contributed assets to the new entity. In return, the partnership assumed primary responsibilities for liabilities, although the transferors guaranteed payment. The corporations asserted no sale had occurred and sought refund of sales taxes paid. The trial court ordered a refund but the appellate court reversed, finding the case before it indistinguishable from Cal-Metal, as both involved a commencing partnership and the assumption of liabilities. The court noted that even absent an express agreement by the transferor to remain liable, corporations Code section 15015 imposed such an obligation in specifically providing that partners are liable for the debts and obligations of the partnership. The court distinguished the Macrodyne decision: "Macrodyne concluded the parent company received no consideration for it was, in effect, transferring the liabilities from one pocket to another. In Cal-Metal, and our case, the transfer is to a third pair of pants worn by a third person and thus lightens the load of the pockets of both [partners]. This is so even if the third parties' pockets fail to hold the debts (by failing to pay them) and the debts are effectively

Plaintiffs acknowledge there was no express agreement between the parties that [G] was to remain jointly liable for [U]'s liabilities, but assert plaintiffs' failure to obtain the consent of its creditors to the transfer compels the same result. In support of this argument, they cite Civil Code section 1457, which provides: "The burden of an obligation may be transferred with the consent of the party entitled to its benefit, but not otherwise." Plaintiffs also rely on former Commercial Code section 6105, which provided any bulk transfer made without giving the requisite notice is "fraudulent and void against any creditor of the transferor." Plaintiffs contend that because creditors were not notified of the transfer and did not consent, [G] remains jointly liable for [U]'s obligations and thus it did not receive any benefit or consideration from the transaction.

Plaintiffs err in equating this potential, secondary liability with the absolute liability incurred when a transferor expressly agrees to remain jointly liable. It is true, of course, that [G] remained secondarily liable for the assigned debts of its Division. "Where the subject matter of the assignment (e.g., a bilateral contract) involves reciprocal rights and duties, the assignor may transfer the benefits, i.e., he may divest himself of his rights: but he cannot escape the burden of his obligation by a mere assignment. The assignor still remains liable to the promisee. Even if the assignee assumes the obligation, i.e., agrees to perform it, the assignor still remains secondarily liable as a surety or guarantor, unless the promisee releases him or the parties

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returned to the solid pockets of the partners. The partners would have received a consideration, a benefit, at the time of transfer of title though ultimately the consideration failed of value. The benefit received was that [the commencing partnership] became the primary obligor on the liabilities at the time of the transfer of title[,] hence the tax applied." (5 Cal.App.4th at p. 1240.)

Contrary to plaintiffs' apparent belief, nothing in either Cal-Metal or Industrial Asphalt suggests a different set of rules applies if the new entity is a corporation instead of a partnership. Indeed, regulation 1595 specifically applies to both a "commencing corporation or commencing partnership." The general question remains the same: did the transferor receive consideration, such as the assumption of indebtedness? The answer here is clearly affirmative.

execute a complete novation." (1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 943, p. 841, emphases in original.) Nevertheless, in the event that [G] were required to pay a creditor on an assigned debt, it would then be entitled to sue [U] for breach of the contract of assignment and to collect all of the money it paid to the creditor. Thus, as between [G] and [U], the parties were not jointly liable. Instead, [U] was solely liable under the assignment agreement because it there "assumes and agrees to pay, perform and discharge all debts and liabilities of [Division] of any kind, character or description whether accrued, absolute, contingent or otherwise, …"

In short, the transaction at issue here falls squarely within the parameters of the regulation and applicable statutes. [U] assumed the liabilities of [G]'s Division, thus conferring a benefit on [G] and satisfying the consideration requirements for a sale. The trial court properly concluded plaintiffs were not entitled to a refund of state sales tax.[5]

Plaintiffs contend no sale occurred because they did not intend there to be consideration but only a contribution to capital of the subsidiary. An identical claim was rejected in Cal-Metal, where the court noted the agreement specifically called for transfer of assets to a separate legal entity. (Cal-Metal, supra, 161 Cal.App.3d at pp. 765-766.) As another court aptly noted: "[T]here is a significant difference between wholly owned, but separate corporations, and divisions of a single corporation…. [A] business may elect various forms to accomplish what it regards as valuable advantages. If it elects to conduct that business through the device of separately incorporated, although wholly owned subsidiaries, and thereby obtain the advantages of separate corporate entities, it must also suffer whatever disadvantages attach to that election. [A business may not] secure the advantages of the form it selects and.… avoid the disadvantages

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[5] Because we conclude the benefit to [G] satisfied the consideration requirment, we have no occasion to address plaintiffs' claims that [U] suffered no detriment.

which accompany, and are the price of, its election." (Mercedes-Benz v. State Bd.. of Equalization (1982) 127 Cal.App.3d 871, 874.)

Plaintiffs assert that even if this transaction constituted a sale, they should be exempt from sales tax under the "occasional sales" provisions of sections 6006.5, subdivision (b) and 6367.[6] Plaintiffs expressly disavowed this theory at trial and informed the court: "Plaintiffs do not assert that [G] Corporation's transfer of its [U] Division to its wholly-owned subsidiary, [U] Corporation, was exempted from tax as an occasional sale. Instead ... [p]laintiffs are simply arguing that because there was no consideration, there was no sale, and no sales tax may be lawfully imposed." (Emphases in original.) Plaintiffs are therefore precluded from raising such a claim here. " 'The rule is well settled that the theory upon which a case is tried must be adhered to on appeal. A party is not permitted to change his position and adopt a new and different theory on appeal. To permit him to do so would not only be unfair to the trial court, but manifestly unjust to the opposing litigant…'" (Richmond v. Dart Industries, Inc. (1987) 196 Cal.App.3d 869, 874.)

DISPOSITION

The judgment is affirmed.

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[6] Section 6367 provides in relevant part: "There are exempted from the taxes imposed by this part the gross receipts from occasional sales of tangible personal property and the storage, use, or other consumption in this state of tangible personal property, the transfer of which to the purchaser is an occasional sale."

Section 6006.5, subdivision (b) defines "occasional sale" to include: "Any transfer of all or substantially all the property held or used by a person in the course of those activities when after the transfer the real or ultimate ownership of the property is substantially similar to that which existed before the transfer. For the purposes of this section, stockholders, bondholders, partners, or other persons holding an ownership interest in a corporation or other entity are regarded as having the 'real or ultimate ownership' of the property of the corporation or other entity."

SPARKS, J

We concur:

PUGLIA, P.J.

DAVIS, J.