

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

535.0004

In the Matter of the Petition)
for Reconsideration of) DECISION AND RECOMMENDATION
Successor Liability;)
)
T--- CORPORATION, et.al.) No. SR --- XX XXXXXX-010
dba M---/C--- M---)
)

Petitioner.)

The above-entitled matter came on regularly for hearing on Thursday, December 22, 1983, in Covina, California before Robert H. Anderson.

Appearing for Petitioners:

Mr. D--- E. S---
Attorney at Law
---, ---, ---, --- & ---

Appearing for the Board:

Mr. Lee Smith
Auditor
Covina Branch Office

Protest

On August 9, 1982, petitioner was issued a notice of successor liability as a successor to C---
- M--- Corporation. The assessment was for the following amounts:

<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Total</u>
\$15,884.88	\$21,322.94	\$3,688.49	\$40,896.31

*Interest calculated through 8-9-82 and is increasing at the rate of \$7.83 for each day payment is made after August 9, 1982, to date of payment.

Petitioner protests the assessment as successor.

Contentions

Petitioner is not a successor under authority of *People v. Gabriel*, (1943) 57 Cal.App.2d 788.

Petitioner's predecessor, as a successor in line, obtained a sales tax clearance certificate from the Board for the transaction out of which petitioner is being held to be a successor.

Summary

This controversy arises as a result of a sale of a business to a commencing partnership.

Petitioner is assessed tax as a successor to a corporation which is also a successor, and the assessment in this matter is what is left in an earlier assessment against the corporation's predecessor.

Background: In 1977 there was a Delaware corporation known as P & F I---. P & F I--- had offices in ---, New York and a division in California known as C--- M---, hereinafter Old C--- M---. P & F I--- had qualified to do business in California and its division, Old C--- M---, held seller's permit number SR -- XX XXXXXX.

Old C--- M--- was audited for the period from 7-1-75 through 8-31-77, and a determination was issued for tax, interest and penalty on December 21, 1978. The assessment was for use tax on ex-tax assets purchased and on inventory withdrawn and consumed. Between February of 1979 and February of 1980 payments were made by or received from P & F I--- which were credited to the Old C--- M--- Account.

P & F I--- sold the C--- M--- division (Old C--- M---) to R--- M--- who upon incorporating the business took the name C--- M--- Corporation, hereinafter New C--- M---. New C--- M--- was issued seller's permit number SR --- XX XXXXXX. New C--- M--- is a successor to Old C--- M---.

In April of 1980 P & F I--- was suspended from trading stock on the American Stock Exchange and subsequently the corporation dissolved and filed a Chapter 7, no assets, bankruptcy. A successor billing was issued to New C--- M--- in April of 1979.

In 1980 New C--- M--- sold its assets to a partnership entity known as M---, hereinafter M--- Partnership. M--- Partnership holds a seller's permit number SR --- XX XXXXXX and is the petitioner in this matter.

The M--- Partnership is made up of C--- M--- Corporation (New C--- M---) which owns a 50 percent interest. The other partner is M--- Co. which owns a 50 percent interest. M--- Co. is a State of Washington partnership made up of two State of Washington corporations: (1) D--- I---, and (2) R--- L---. The foregoing description of M--- Partnership is taken from the M--- Partnership agreement dated February 1, 1980.

In a petition for reconsideration of successor liability dated September 23, 1982, Mr. D--- E. S---, counsel for petitioner, stated that he represented T--- Corporation, a partner in M---, a general partnership doing business as C--- M---. However, that is not apparent in any of the records made available to the hearing officer except that the Notice of Successor Liability was issued to T--- Corporation, et al., doing business as M---/C--- M---.

Be that as it may, the transfer of assets giving rise to the successor-to-successor liability (M--- Partnership successor) under consideration in this petition triggered a sales tax assessment against New C--- M--- for tax on the sale of the business to the commencing M--- Partnership.

The M--- Partnership successor liability amount in question in this petition does not include the tax on the sale of the business assets to the M--- Partnership. The amount in question is what is left of the tax plus accruing interest on it that was originally set up against the original or Old C--- M--- (the California division of P & F I---) and which the first successor (New C--- M---) has not paid.

In respect to the tax on the sale of the assets to the M--- Partnership, it was paid by New C--- M--- who is presently suing the Board for a refund in the Los Angeles Superior Court (C--- M--- Corporation v. State Board of Equalization, No. -XXXXXX) claiming that the transfer of assets to M--- Partnership was not a sale because (1) it was to a commencing partnership; (2) there was no consideration; and (3) if it was a sale only 50 percent of the measure of tax should be taxed since the plaintiff-transferor owned 50 percent of the transferee M--- Partnership entity.

The "no consideration" argument was rejected by the Board because the M--- Partnership assumed the liabilities on the assets transferred. New C--- M--- is suing for a refund of \$73,000; the case is being handled by Deputy Attorney General Patti Kitching who, in the latter part of February, prevailed on a motion for summary judgment against New C--- M---, the plaintiff. It is understood that New C--- M--- Corporation-plaintiff will appeal the summary judgment.

The foregoing is important to the successor issue in this petition because if New C--- M--- Corporation-plaintiff prevails there would be no sale of assets to M--- Partnership and therefore no M--- Partnership successor.

The successor issue is further complicated by the fact that a [Mr.] M--- is the sole surviving shareholder of C--- M--- Corporation (New C--- M--- successor to Old C--- M---) and there is reportedly an indemnification agreement from Mr. M--- to cover the M--- Partnership successor liability, if any. Note also, that the New C--- M--- successor liability is still substantial and is in excess of \$40,000 counting interest. The tax is almost \$16,000. Mr. M--- offered the Board \$15,000 as a compromise settlement to release the New C--- M--- successor liability and a full release of all claims against future successor entities which would be the M--- Partnership and any successors to the M--- Partnership that would inherit the original or Old C--- M--- liabilities.

The \$15,000 settlement offer was turned down in light of the lawsuit by C--- M--- Corporation (New C--- M---) that is seeking a refund of \$73,000 from the Board. However, headquarters suggested to the --- district that Mr. M--- be counter offered a settlement proposal in the amount of \$25,000. Apparently this counter proposal was made to Mr. M--- because his attorney, who incidentally is not Mr. S---, wrote on July 20, 1983 to the --- district and stated that his client was making the \$25,000 settlement offer conditioned upon full releases of all parties including M--- Partnership (referred to as T---) interest. A copy of the letter is in the petition file; the original is in the master file.

The position already taken by the Board is that M--- Partnership purchased the business assets from New C--- M---, and as noted, the Board has assessed sales tax on the sale. This would automatically make M--- Partnership a successor. However, the issue of whether M--- Partnership is a successor appears to technically hang on the outcome of C--- M--- Corporation's (New C--- M---) suit for refund on the tax paid on the sale of its business to the M--- Partnership. And, as noted, if C--- M--- Corporation prevails there would be not sale and without a sale there would be no successor as far as the M--- Partnership is concerned. On the other hand, if the Board prevails, as it has so far by reason of the summary judgment against C--- M--- Corporation, we still have the M--- Partnership successor that is being assessed what is left of the original liability assessed against Old C--- M--- (SR -- XX XXXXXX) and which New C--- M--- (through its shareholder [Mr.] M---) has offered a \$25,000 compromise settlement to release all claims against New C--- M--- as well as the M--- Partnership successor liability.

Conclusions

M--- Partnership (petitioner herein) is a successor to New C--- M--- that is a successor to Old C--- M--- and is liable for what is left of the tax, interest which is still accruing, and penalty on the original liability assessed against Old C--- M---.

We make no conclusion or recommendation on the compromise settlement offer. However, we do note that if there is no M--- Partnership successor as a result of the appeal on the summary judgment by C--- M--- Corporation (New C--- M---) there is still a successor liability outstanding against New C--- M---.

The case of *People v. Gabriel*, (1943) 57 Cal.App.2d 788, cited by counsel, holds that a purchaser of fixtures and equipment is not liable for sales tax due from the seller, on account of failing to withhold sufficient of the purchase price to cover such liability when the evidence showed that the purchaser did not purchase the business of the former owner (of the fixtures and equipment) or become his successor to the business.

People v. Gabriel is not authority for petitioner's release from the successor's liability. The partnership entity purchased New C--- M---'s business. The agreed upon fair market value of New C--- M---'s interest in the business was \$2,800,000. M--- Partnership, the purchaser, assumed New C--- M---'s liabilities in the amount of \$1,242,435 and for this New C--- M--- received a 50% interest in the M--- Partnership. Sales tax measured by \$1.1 million was assessed on the sale of the fixtures and equipment.

The reorganization into the 50-50 partnership entity was one that resulted in a sale by reason of the assumption of the liabilities which is consideration (see *U.S. v. Hendler*, (1937) 303 U.S. 657; *Newco Leasing v. State Board of Equalization*, (1983) 143 Cal.App.3d 120). The sale does not qualify for the occasional sale exemption under section 6367 of the Sales and Use Tax Law because it was not an occasional sale as defined under section 6006.5(b) in that after the transfer the real and ultimate ownership held by New C--- M--- was not substantial which requires retaining at least 80 percent; New C--- M--- only retained a 50 percent interest.

Finally, New C--- M--- is properly being held liable for the tax owed by Old C--- M--- as a successor. There was no sales tax clearance obtained from the Board on the purchase of the Old C--- M--- business. Thus, the remaining New C--- M--- successor liability carries over to the next-in-line successor which is M---/C--- M---, petitioner herein.

According to the audit staff, petitioner sometimes transferred sketches and patterns to customers who had elected not to purchase costumes from petitioner. Unless otherwise exempt, tax would apply to these transactions measured by the portion of the design fees allocable to the sketches and patterns transferred. The tax applies not because the design is part of the sale of costumes, but because the transfer of sketches and patterns is itself a sale of tangible personal property.

Recommendation

No adjustment to the successor liability assessment.

Robert H. Anderson, Hearing Officer

3/6/84

Date