

**STATE BOARD OF EQUALIZATION**

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March 11, 1996

The Board's Taxpayers' Rights Advocate Office has forwarded your letter dated February 2, 1996 to this office for response.

In your letter, you requested the assistance of the Taxpayers' Rights Advocate in resolving a dispute as to the successor liability imposed on _____. In 1992, _____ purchased the inventory of another company. At that time, the company from which the inventory was purchased was indebted to the Board for unpaid sales taxes in the sum of \$201,788.13. _____ agreed, as sole consideration for the purchase of the inventory, to pay all of the seller's obligations that were secured by the inventory purchased directly to the seller's lender.

When the Board issued its Notice of Successor Liability to _____, _____ filed a timely petition for redetermination. You state that at the hearing on the taxpayer's petition, the taxpayer appeared without counsel and that if the taxpayer had been represented by counsel, the taxpayer's attorney would have cited the case of *Knudsen Dairy Products Co. v. State Bd. of Equalization* (1970) 12 Cal.App.3d 47, which you contend absolves _____ from any liability. You ask that Board conduct an informal review of _____ liability with consideration of the *Knudsen* case.

Sales and Use Tax Regulation 1702(a) provides, in part:

"The requirement that a successor or purchaser of a business or stock of goods withhold sufficient of the purchase price to cover the tax liability of the seller, arises only in the case of the purchase and sale of a business or stock of goods under a contract, providing for the payment to the seller or person designated by him of a purchase price in money or property or providing for the assumption of liabilities"

In *Knudsen Dairy Products Co. v. State Bd. of Equalization, supra*, the Board assessed a successor liability against Knudsen Dairy for which Knudsen Dairy subsequently sought a refund. The liability arose as follows:

Pix Food Markets, Inc. was a debtor of Knudsen Dairy. Knudsen Creamery Co., the parent of Knudsen Dairy, made loans to Pix. An agreement was reached whereby creditors of Pix (with the exception of Knudsen Creamery) would receive cash for their claims

against Pix. Under the agreement, Pix transferred assets to Knudsen Dairy. Knudsen Dairy then issued to Pix a promissory note for the value of the assets received. Knudsen Creamery then credited Pix, in reduction of its indebtedness, in the amount of the value of the assets transferred.

On appeal, Knudsen Dairy argued that successor liability was improper because there was no purchase price paid from which a withholding could have been made. The appellate court responded:

"[I]t is clear that in the circumstances of present day business practice it would be illogical to hold that a 'purchase' price must take the form of cash or tangible property. Most, if not all, purchases of any size and substance in today's economic world involve a promissory note or at least some part of the purchase price.

"The legislative intent on this point appears quite clear. The sections under question formerly used the phrase 'purchase money.' By amendment in 1941, the term 'purchase money' in section 6811 was changed to 'purchase price' and in section 6821 to 'purchase price valued in money.'

"Plaintiffs urge that Dairy was not a 'purchaser' in that it had no privity with Pix, but simply received the assets at Creamery's direction. Therefore, plaintiffs suggest that defendant, if it assessed anyone, should have assessed Creamery. However, plaintiffs also take the position that in the final analysis Creamery could not be held liable because it paid no 'purchase price' from which a withholding could have been made and to do so would unconstitutionally impose liability for failure to perform a duty which was impossible of performance.

"We agree with plaintiffs that the successor liability cannot be imposed when the duty to withhold, as here defined, under section 6811 cannot possibly be performed by the successor.

"However, as we interpret it, the term 'withhold' as used in the statute does not necessarily mean having physical assets in hand but simply means dealing with the purchase consideration in such a manner as to deny to the seller the benefit of the purchase consideration and to thereby make a portion of it available for the satisfaction of the tax liability.... It would have been a simple matter for Creamery, at the time that the liquidation plan was being developed, to provide that cash be set aside for the payment of the tax liability or that sufficient assets be retained by Pix to satisfy the tax liability and to that extent reduce the credit which it afforded Pix in the reduction of its indebtedness. Similarly, Dairy could have reduced, by the amount of the tax liability, the size of the note which it gave to Creamery." (12 Cal.App.3d 55-56.)

In affirming the trial court's decision denying the refund, the appellate court approved the trial court finding that:

"Sections 6811 and 6812 of the Revenue and Taxation Code imposed a reasonable duty upon Dairy to provide for payment of Pix's unpaid tax liability in the negotiations resulting in Dairy's purchase of Pix's business and assets, and imposed a reasonable duty upon Dairy to withhold sufficient to the purchase price to pay Pix's tax liability to defendant." (12 Cal.App.3d at 57.)

When _____ negotiated for the purchase of the inventory of the other company, it "paid" for the inventory by its promise to pay the purchase price directly to the other company's lender. Under the holding of the *Knudsen* case, _____ had a duty to structure its purchase agreement with the other company in such a manner as to provide for the payment of the outstanding tax liability to the Board. Successor liability was properly imposed upon _____ by its failure to do this.

Very truly yours,

Thomas J. Cooke
Staff Counsel