

M e m o r a n d u m

535.0074.500

To: Mr. Rick A. Slater
Supervisor, Special Procedures Section

Date: March 18, 1997

From: Thomas J. Cooke
Tax Counsel

Subject:

Gary Jugum requested that I respond to your memorandum to him dated March 12, 1997 concerning the above taxpayer.

In your memorandum, you state that the _____ has requested an opinion as to whether there is successor liability as the result of the transfer of assets pursuant to an "Agreement For Repossession Of Collateral In Satisfaction Of Debt."

_____ operated a business from 12/75 to 8/1/96. This corporation currently owed the Board \$3,939.27. On September 6, 1996, _____ applied for a seller's permit. They claimed that they repossessed the business of _____. They submitted a copy of "Agreement For Repossession Of Collateral In Satisfaction Of Debt" dated August 2, 1996. The _____ were issued a seller's permit with an effective date of August 2, 1996. The corporation's seller's permit was closed out effective August 1, 1996.

The "Agreement For Repossession Of Collateral In Satisfaction Of Debt" is dated August 2, 1996. The agreement that on or about January 7, 1991, _____, as sellers, entered into an agreement with _____, as buyers, for all of the capital stock in _____. In connection with this sale, "Debtors" (_____) executed promissory notes, security agreements and a Pledge Agreement for the purchase of the stock. These documents were later assigned by the _____ to the 1992 _____ Revocable Trust. _____ also entered into a lease of premises in _____, California effective February, 1991.

Mr. and Mrs. _____ defaulted on payments due under the promissory notes. The "Agreement For Repossession Of Collateral In Satisfaction Of Debt" provided that Mr. and Mrs. _____ shall, on August 2, 1996, turn over all "collateral" to the Trust. Mr. and Mrs. _____ also agreed to turn over to the Trust all certificates for any shares of the _____ Corporation. The agreement further provided that upon the Trust's "receipt of the Collateral, all obligations of Debtors under the three promissory notes shall be deemed satisfied." The agreement also authorized the Trust and the Trust's "assignees to use and to do business under the name ' _____'." The agreement was signed by _____ (by its president, _____, my Mr. and Mrs. _____ and by Mr. and Mrs. _____ individually and as trustees of the 1992 _____ Revocable Trust.

The taxpayer from 1975 to August 1, 1996 was the corporation, _____. The corporation was also the “person” described in Revenue and Taxation Code section 6811. When Mr. and Mrs. _____ defaulted on the payments due under the promissory notes, they turned over the corporation’s property to the Trust pursuant to the Agreement. The Trust assigned this property to the _____ who applied for a seller’s permit to operate the business in their own names. We believe that the facts in this case are similar to *Knudsen Dairy Products Co. v. State Board of Equalization* (1970) 12 Cal.Appl.3d 47 in which one party directed the taxpayer to transfer its assets to another party. In *Knudsen*, the court stated:

“In a purchase and sale, the purchase price need not necessarily flow directly to the seller. The fact that the purchase price here went to a third part, to wit, Creamery, does not militate against the finding that Dairy was a ‘purchaser’” (12 Cal.App.3d at 54).

Mr. and Mrs. _____ turned over the corporation’s property to the _____ Trust in exchange for satisfaction of their personal debt to the _____. The _____ obtained property from the Trust and continued the business. It is our opinion that successor liability may properly be imposed against the _____ for the corporation’s tax liability.

Memorandum

To: Ms. Ruth Snyder
Compliance, Industry Office

Date: March 28, 1997

From: Thomas J. Cooke
Tax Counsel

Subject:

The Legal Section has received your memorandum dated May 22, 1997 concerning the above taxpayers.

In your memorandum, you state that attorney X on behalf of his clients, Mr. and Mr. B, contends that successor's liability does not apply to his clients pursuant to the excluded transactions set forth in the California Administrative Code, at 18 C. C. R. Section 1702 and that the procedure for a secured party to retain the collateral in satisfaction of debt is specifically provided for in California Uniform Commercial Code section 9-505 as a manner of disposing of collateral in lieu of foreclosing under a security agreement.

The facts under which successor liability was imposed are stated in our earlier opinion dated March 18, 1997, a copy of which is attached.

In 1991, Mr. and Mrs. A entered into an agreement for the purchase of the stock of the corporation known as _____. In the petition for redetermination, X states that the collateral for the promissory notes given by the A's consisted of corporate assets, i.e., furniture, fixtures, equipment, etc. When X states that the A's turned over the collateral to the B's and renounced all of their rights in the collateral, X assumes that the A's, and not the corporation, had rights to the collateral. We find no ownership interest by the A's or the B's in the tangible personal property transferred to the B's by the agreement dated August 2, 1996, prior to the execution of that agreement.

When the B's "foreclosed" on the security interest retained for their sale of the corporation's stock, the agreement dated August 2, 1996 transferred the corporation's tangible personal property to them for a consideration. The B's therefore, purchased the corporation's property. If the corporation had sold the tangible personal property to the A's the corporation may have utilized California Commercial Code section 9505 as a manner of disposing of collateral in lieu of foreclosing under a security agreement. Since the B's were not "sellers" of tangible personal property, they may not assert that the August 2, 1996 agreement was a "foreclosure" substitute.

Since the B's, as "purchasers," were also "successors," successor liability was properly imposed.