STATE OF CALIFORNIA

BOARD OF EQUALIZATION

APPEALS DIVISION

In the Matter of the petition for Reconsideration of Successor Liability Under the Sales and Use Tax Law of:	)	HEARING DECISION AND RECOMMENDATION
Petitioner	)	

The above-referenced matter came on regularly for hearing before Hearing Officer W. E. Burkett on February 19, 1991, Oakland, California.

Appearing for Petitioner:

Appearing for the Sales and Use Tax Department: Mr. Orval Millette
District Principal Auditor

Protested Item

Petitioner protests the assertion of successor liability. Liability was asserted in a notice dated January 5, 1989. The amount of the protested liability is $71,530, plus interest of $63,495.55 and a penalty of $7,153 for a total combined amount of $142,178.55.

Contentions of Petitioner

1. The Board failed to give a timely notice of successor liability.

2. The petitioner is absolved from liability because the seller has been released from all further liability.

3. The finality penalty is not applicable.

4. In any event the measure of tax is incorrect.

Summary

The petitioner is a corporation that has been held to be the successor to _____ and therefore liable for the unpaid tax liability of _____ in the amount of tax of $71,530, interest of $63,495.55, and penalty of $7,153 for a total combined demand of $142,178.55. Petitioner has

paid the liability under protest and is pursuing this matter as a petitioner and as a claim for refund.

_____ was a wholly-owned subsidiary of _____. On December 28, 1984, petitioner entered into an agreement with _____ and _____ to purchase certain operating business locations of _____. In order to facilitate the sale, _____ agreed to indemnify petitioner for any unpaid sales and use tax liabilities of _____.

On February 11, 1987, both _____ and _____ filed for reorganization under Chapter 11 of the United States Bankruptcy Act. Subsequently, on September 27, 1988, petitioner was served with a notice of successorship liability of _____ in the total amount of $421,666.67 which was subsequently reduced to $291,002.35. All of this remaining liability of _____ except for the aforementioned $142,178.55 was settled by agreement between the Board of Equalization and _____ whereby the amount was offset against refunds due to _____ by the Board. _____ was a party to this agreement, but the petitioner was not.

On July 30, 1990, _____ amended its agreement to basically provide that funds supplied by, _____ could be used to satisfy one half of the liability plus cost up to a maximum of $210,000. If the sum ultimately due was less than this amount, then one half of the funds was to go to _____. Petitioner was to pursue the claim and any net refund it received was to be shared with _____. While we have not been provided with a copy of the original indemnity agreement dated May 17, 1989, we understand that _____ was not a party to such agreement. _____ was also not a party to the first amendment to this agreement which was executed on July 30, 1990.

Petitioner agrees that it was properly classified as the successor to _____. It contends, however, that it was absolved from the successor liability of _____ on the following independent grounds:

1. The Board failed to give it a timely notice of successor liability so that it could file its claim against _____ and _____ in the Bankruptcy Court.

2. The petitioner is absolved of any liability as a successor because the Board released _____ from any further liability in an agreement filed with the Federal Bankruptcy Court on August 1, 1990.

3. The penalty of $7,153 is a finality penalty. It is not applicable because the Federal Bankruptcy Court assumed jurisdiction of the protested tax claim prior to the date the finality penalty became due.

A statement seeking relief under the provisions of Revenue and Taxation Code Section 6592 has been filed with the Hearing Officer. While the statement does not include a copy of the Notice of Determination, it does contain a copy of the original report of field audit which is dated August 21, 1987.

4. The petitioner has made several arguments relating to the merit of applying the tax to several categories of drum sales. These relate to deficiencies assessed for sales of new

drums, used drums and reconditioned drums. The underlying allegations and arguments are set forth in handwritten notes prepared by _____. They have been marked as Exhibit A attached hereto and are incorporated herein by reference. The petition does not separately allege the amount of the adjustment for each item. Therefore, in the event an adjustment is required, reference must be made to the report of field audit of _____.

Analysis and Conclusion

The petitioner's claim that it was not provided with a timely notice thus precluding the filing of a claim in bankruptcy is rejected as being without merit. The code provides a method whereby the purchaser can obtain assurance that all liabilities of the seller have been satisfied or a certificate absolving the purchaser of any liability as a successor. (See Revenue and Taxation Code Section 6812.) If a purchaser fails to avail himself of this relief measure, then it is not in a position to complain. In People v. Buckles, (1943) 57 Cal.App.2d 76, 81, the proposition was aptly stated by the court as follows:

> "We believe that what we have heretofore said sufficiently answers this argument but deem it proper to observe that section 26 of the act provides a simple method by which a purchaser may protect himself. He can require the seller to produce a receipt from the board showing that all taxes have been paid or a certificate stating that no taxes, interest or penalties are due, before turning over any part of the purchase price. This requirement is both simple and salutary. If a purchaser chooses to rely upon the assurance of the seller that all taxes have been paid and pays over the entire purchase price without protecting the state or himself by demanding such receipt or certificate, he has no just cause to complain if it is thereafter determined by the board that the seller has failed to pay the sales tax due to the state and his statutory liability as purchaser is enforced."

There is nothing in the statutes or regulations that requires that the obligation of the successor be fixed within a certain time of the filing of a petition in bankruptcy. The evidence indicates that the Department was not dilatory in determining the seller's liability and giving notice of successor liability.

Our review of an endorsed copy of the settlement agreement discloses that _____ was not absolved of the tax liability here considered until such time as the liability was paid. Petitioner agreed to make this payment and this payment was a condition of the Board's duty to perform under the agreement.

The provisions of the Sales and Use Tax Law do not provide that the liability of the successor is akin to a surety or that the Board must first exhaust its remedies against the seller. It is an independent liability that arises by reason of its status as a purchaser of the seller's business or stock of goods. The underlying basis is that the purchaser should be held liable because of the acquisition of the seller's assets that were previously available to satisfy the seller's liability.

It is our conclusion that the 10% finality penalty is not applicable. This penalty was added long after the petitioner came under the jurisdiction of the federal bankruptcy court as a contested tax claim.

The Objections to the Amount of the Tax Deficiency Determined

New Drum Sales: The first objection relates to the amount of the tax deficiency determined for sales of new drums claimed to be exempt from the tax. The explanation is that internal auditors for _____ inadvertently destroyed the proof of exemption. It is argued that the Board should accept a factor of error based upon a prior audit period.

We cannot agree that the evidence of prior reporting history is a satisfactory basis for the adjustment of the measure of tax for this item. Sales of new drums may be taxable or exempt depending upon the needs of a particular customer and actual proof of exemption must be required.

Used Drum Sales: The second objection relates to the outright sale of used steel drums. Basically we are told that some customers decide to purchase the used drums because they are substantially cheaper than the new drums.

It is contended that sales of used drums should be allowed exemption because they are by their very nature resold for refilling. Alternatively, it is submitted that the factor of error used to compute the measure of disallowance be based upon prior or subsequent audit periods.

We find no basis for the granting of an exemption solely on the basis that the drums sold were steel containers that could function as returnable containers. Under the terms of the exemption, this depends upon whether the drums were returnable containers resold for refilling. This, in turn, depends upon the purchaser's method of conducting business and the actual use of the drums.

The claim that the factor of error should be based on prior audits or the subsequent audit of petitioner is rejected for the same reasons as set forth in our discussion of the protested new drum sales.

Reconditioned Drum Sales:

The petitioner regularly exchanges used drums for other similar drums reconditioned by petitioner. These drums are used by companies engaged in marketing oil, paint, chemicals and similar products. Except for certain transactions qualifying as sales for resale or as sales of non-returnable containers, the exemption was denied on the basis that petitioner had failed to prove that the property was originally sold for use as returnable containers.

All parties agree that the value of the paint, rust proofing, hinges, plugs, gaskets, and other sundry items plus reimbursement for overhead and profit thereon would amount to more than 10% of the total charge for reconditioning. It is also agreed that all drums are commingled and that the customer does not receive the same drum turned over to petitioner.

The petitioner relies heavily on a prior ruling issued by R. H. Anderson for a prior petition of a determination issued against this taxpayer for the period January 1, 1968 to March 31, 1971. In this prior matter, the Hearing Officer concluded that the transactions involved sales of the drums, but that the transaction qualified for exemption as a returnable container resold for refilling. (Revenue and Taxation Code Section 6364(c).)

The Department contends that the petitioner should have become aware of the application of the tax through certain Tax Information Bulletins, and in any event, it bears the burden of proving that the items exchanged were previously returnable containers.

We conclude that the Board is bound by R. H. Anderson's prior ruling on precisely this same point. There was a request for a ruling in the form of a written protest. A written ruling thereon was issued by Mr. Anderson and the petitioner reasonably relied on this ruling until the audit which gave rise to this petition. The matter, therefore, meets all of the requirements for relief under the provisions of Revenue and Taxation Code Section 6596. While the determination period here considered is prior to January 1, 1985, the effective date of Section 6596 has been uniformly applied to all pending matters. We are not persuaded that the taxpayer knew or should have known about the Department's interpretation.

It is our considered conclusion, however, that the prior ruling is overly broad and partially incorrect. The provisions of Sales and Use Tax Regulation 1589 provide the following definition of a returnable container:

> "The term 'returnable containers' as used herein means containers of a kind customarily returned or resold by the buyers of the contents for re-use by the packers, bottlers or sellers of the commodities contained therein. A container, title to which is retained by the seller of the contents, or for which a deposit is taken by such seller, is a returnable container. Examples of returnable containers are: registered dairy products containers, steel drums, certain types of beer and soft drink bottles, wine barrels, chemical carboys, and gas cylinders."

The fact that these particular containers were "steel drums", a type of container customarily returned for reuse coupled with the fact that the containers were exchanged in a used condition for other drums acquired for refilling, is satisfactory evidence that they were previously returnable containers.

The prior ruling was premised on the conclusion that there was an exchange sale of the steel drum, but that it was an exempt retail sale under the provisions of Revenue and Taxation Code Section 6364(c) because the drum was "resold for refilling".

We believe this conclusion is correct with respect to the steel drum. In enacting this provision, the Legislature undoubtedly concluded that repeated recurring sales of the drum should be exempt because the initial retail sale of the drum would ordinarily be taxable. However, the commonly understood meaning of the term "resold" cannot be construed to include tangible personal property that was not previously sold nor is there any indication that initial

taxation of such property was not intended. Therefore, the petitioner should, for future periods, be considered as the retailer of such property where it is otherwise sold in a transaction classified a retail sale. It would seem appropriate that this interpretation be embodied in the regulation.

Recommendation

1. The 10% finality penalty should be deleted.

2. The measure of tax deficiency attributable to reconditioning of drums should be deleted from the measure of tax. A reaudit of _____ will be required for this adjustment.

_____ 3-21-91

W. E. BURKETT, HEARING OFFICER DATE