



STATE BOARD OF EQUALIZATION

(916) 445-6450

February 28, 1985

This is in reply to your January 9, 1985 letter regarding the effect of the case, Knudsen Dairy Products Co. v. State Board of Equalization, 12 Cal.App.3d 47, on the successor liability of _____ under the following facts.

You noted that _____ (the Corporation) intends to acquire from _____ (the Seller) a restaurant named _____ (the Business). The assets owned by the Seller and used in connection with the Business consist of the name _____, any goodwill attributable to the location, the on-sale beer and wine license, and the inventory. The Seller has agreed with the Corporation to transfer his rights in the assets to the Corporation in exchange for the sum of \$1001.00. Of the \$1001.00, one dollar has been allocated to the goodwill, the name, and the license, and \$1000.00 has been allocated to the inventory. The real property and all furniture, fixtures and equipment, are owned by a third party who is unrelated to the Seller or the Corporation.

We understand that, the Corporation is wholly owned by _____ who is the sister of the Seller. _____ has transferred to the Corporation, as part of the initial contribution to capital, a portion of her interest in a promissory note from the Seller to her. The Corporation will discharge the Seller's indebtedness to the extent of \$1001.00 as payment of the purchase price of the Business. No other consideration will be transferred from the Corporation to the Seller for the assets being purchased.

From your reading of the Knudsen case, supra, you believe that the Corporation would not be liable for any amount to the State Board of Equalization for successor liability. Particularly, you refer to headnote No. 2 of the case, which states:

“For the successor or assign of a business to become personally liable for the sales tax liability of another under Rev. and Tax Code §§6811, 6812, by failing to withhold a sufficient amount of the purchase price to satisfy the seller's tax liability, such successor must also be a purchaser who through the handling of the purchase price or the form thereof was in a position to protect the state's interest in collecting taxes which were due and owing.”

You also refer to page 54 of the case where the court states that, “We agree with plaintiffs that the successor liability cannot be imposed when the duty to withhold, as here defined, under 6811 cannot possible be performed by the successors”.

You requested that the board issue a certificate stating that no amount of tax is due from _____ as a result of its acquisition of the assets from _____.

It is our opinion that the board cannot issue the certificate, because we believe that, under the facts you described, _____ is subject to successor liability by purchasing the business of _____.

As you know, the board won the Knudsen case. In the facts of Knudsen, as in the facts you described, the seller of the business received a reduction of indebtedness in exchange for the assets which the seller transferred to the purchaser. Although the successor in the Knudsen case paid a third party a promissory note, the successor of the business did not pay cash or tangible property in exchange for the business. In this regard, the court stated that, "...it 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." We believe that the cancellation of indebtedness is a "form" of purchase price as is noted in the headnote to which you refer.

Although the court stated that the successor liability cannot be imposed when the duty to withhold cannot possibly be performed by the successor, the court went on to interpret "withheld" to not necessarily mean having physical assets in hand but to mean dealing with the purchase consideration in such a manner as to deny to the seller the benefit of such consideration and to thereby make a portion of it available for the satisfaction of the tax liability. We believe that, when the only consideration the purchaser gives is the cancellation of the seller's indebtedness, the purchaser may deny the seller the cancellation of the indebtedness and thereby make such consideration available to the state to satisfy the seller's tax liability.

If you have further questions regarding this, feel free to write again.

Very truly yours,

R. L. Dick
Tax Counsel