

M e m o r a n d u m

535.0028

To: Mr. Gary J. Jugum

Date: April 23, 1985

From: John H. Murray

Subject:

Attached is a photo copy of the hearing report submitted on the Petition for Reconsideration of Successor Liability filed on behalf of _____ and some related material from the petition file.

I can see no basis for asserting successor liability under section 6811 and 6812. Indeed this is a classic case of a transfer in fraud of creditors. I think it should be treated as such.

I would suggest that we should proceed in these cases in accordance with the provisions of the Civil Code relating to transfers in fraud of creditors. This could be done either by referring the case to the Attorney General with a request that he bring an action to set aside the transfers or that we levy from the transferred property.

It appears to me that this is a good case for us to discuss at one of our Friday conferences.

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the Petition)
for Reconsideration of) DECISION AND RECOMMENDATION
Successor Liability for State)
and Local Sales and Use Taxes)

The above-entitled matter came on regularly for hearing on January 9, 1985, in Oakland, California before John B. Adamo, Hearing Officer.

Appearing for Petitioner:

Appearing for the Board:

Protest

Petitioner protests the assertion of successor liability. The notice of successor liability was issued March 7, 1984 and reflected a total liability of tax, interest, and penalties of \$111,861.52.

Contention of Petitioner

Petitioner contends that it was not the "purchaser" of the predecessor business.

Summary

Petitioner is a corporation engaged in the sale and leasing of construction equipment. An application for a seller's permit was submitted on behalf of petitioner on December 28, 1983 and was issued effective January 1, 1984.

The immediate predecessor to the business operated by petitioner was _____. Upon audit of the predecessor, the audit staff concluded that Mr. _____ had a substantial unpaid tax liability; a notice of determination was issued on March 11, 1982. Mr. _____ closed out his seller's permit effective December 31, 1983 and the business operation was succeeded, as noted above, by petitioner with an effective starting date of January 1, 1984. The subject notice of successor liability was issued on March 7, 1984.

As further noted below, petitioner contends that it cannot be held liable for the tax liability of _____ because there was no purchase price upon which to base successor's liability. Specifically, petitioner has noted that Mr. _____ executed a declaration of gift, dated February 22,

1983, to his spouse of the assets of the sole proprietorship. Thereafter, Mr. _____ continued to operate the business until December 31, 1983. At the preliminary hearing, petitioner's attorney stated that Mrs. _____ was completely uninvolved with the business conducted by her husband. Petitioner was incorporated in November 1983 and Mrs. _____ contributed the assets gifted to her to petitioner in exchange for stock. Petitioner then commenced operation on January 1, 1984 with Mrs. _____ as the sole shareholder and officer. At the preliminary hearing, petitioner's attorney stated that Mrs. _____ is solely responsible for business operations and that Mr. _____ works only as a commissioned salesman.

Petitioner claims that some of the items that Mrs. _____ acquired by gift in February 1983 were disposed of prior to January 1, 1984; the balance of the items were contributed to petitioner. Petitioner further contends that it did not acquire any of the liabilities of Mr. _____ and has made no payments on any of the sold proprietorship's outstanding obligations. Moreover, petitioner asserts that the business it conducts is different from that of Mr. _____ in that all, or virtually all, of its equipment sales are on a consignment basis. Mr. _____ leased the property where he conducted his business from _____. This lease required that Mr. _____ obtain the prior written consent of _____ to any sublease of the property. Petitioner has submitted a copy of a sublease agreement, effective January 1, 1984, entered into by and between petitioner and Mr. _____ for the sublease of the business property. _____ was not notified of this sublease.

Petitioner contends that it cannot be held liable for Mr. _____ tax liability because under Revenue and Taxation Code Section 6812 there must be a purchase of a business or stock of goods by the successor before the latter can become liable for the predecessor's liability. In this case, petitioner argues, it purchased nothing from Mr. _____ rather, Mrs. _____ was gifted certain items by her spouse and subsequently contributed them to petitioner. The Board's staff has concluded that the sequence of events outlined above is insufficient to relieve petitioner's liability and has reported that Mr. _____ stated to certain of his customers that the actions described above constituted a device designed "to beat those tax people."

Analysis and Conclusions

Section 6811 of the Revenue and Taxation Code provides that if any person liable for any amount under the Sales and Use Tax Law sells out his business or stock of goods or quits the business, his successors or assigns shall withhold sufficient of the purchase price to cover such amount until the former owner produces a certificate from the Board stating that no amount is due. Section 6812 provides that if a purchaser of a business or stock of goods fails to withhold purchase price as required, the purchaser becomes personally liable for the amount required to be withheld by him to the extent of the purchase price.

Civil Code Section 5116, operative January 1, 1975, provides that the property of the marital community is liable for the contracts of either spouse which are made after marriage and prior to or after January 1, 1975. While Section 5116 refers to "contracts," it is well settled that the same rule of community liability extends to tax debts. (See Kingsbury v. United States, 563 F.2d 1019 (1977) wherein the court, applying California law, held that the wife's interest in community property is subject to the tax debts of her husband; see also Weinberg v. Weinberg, 67 Cal.2d 557 (1967); In re Marriage of Smaltz, 82 Cal.App.3d 570 (1978).)

The liability of Mr. _____ was established prior to the purported "gift" to his spouse. Consequently, she too is liable for that debt. In light of California community property law Mr. and Mrs. _____ owned the predecessor business as a husband and wife partnership notwithstanding that Mr. _____ obtained a seller's permit as a sole proprietor. Consequently, in that the _____ continued to operate the business as partners both before and after the supposed "gift," petitioner can properly be held liable as their successor even if only Mrs. _____ received petitioner's stock in exchange for the contribution of assets.

We believe that the record of this petition clearly supports the audit staff's determination that petitioner did purchase the predecessor business and stock of goods. In consideration for that business and its assets, petitioner issued all of its outstanding stock to Mrs. _____. The purchase price is represented by petitioner's issuance of those shares. It is difficult to envision a more complete takeover of a going business than that which occurred here.

There is no authority to support the proposition that the transfer of assets by a partnership in exchange for stock issued by newly-formed successor corporation wholly-owned by a former partner does not constitute a purchase of the predecessor business by the corporation. Indeed, the relevant case law is in contradiction to that position. (See Knudsen Dairy Products Co. v. State Board of Equalization, 12 Cal.App.3d 47 (1970).) In that case, a creamery corporation, which held the outstanding stock of a food market corporation, directed the latter to transfer all of its operating assets to a subsidiary of the creamery. The subsidiary in turn issued to the creamery a promissory note equivalent to the value of the assets received. The creamery then credited the food market corporation, in reduction of its pre-existing indebtedness to the creamery, in the amount of the value of the assets transferred. A closeout audit of the food market corporation by the Board disclosed additional taxes due on certain sales. Under these circumstances, the court held that the subsidiary was a "purchaser" of the food market corporation and that it was liable for the taxes under the provisions of Section 6811 and 6812. We see no reason to reach a contrary result here.

Finally, petitioner's argument that there were no funds from which a withholding could have been made is also misplaced. Section 6812 specifically refers to "purchase price valued in money" (emphasis added); there is no requirement that the purchase price must take the form of cash. (Knudsen Dairy Products Co. v. State Board of Equalization, supra.) It would have been a relatively simple matter for petitioner, at the time it acquired the predecessor business and assets, to provide that a portion of the issued shares be set aside for the payment of the tax liability.

In addition to the above, there is another basis upon which to conclude that petitioner is liable for the tax liability of Mr. _____. Civil Code Section 3439.04 provides that every conveyance made by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made without a fair consideration. Section 3439.09 of the Civil Code sets forth the remedies available where a conveyance is fraudulent as to a creditor. Such a creditor, when his claim has matured, may, as against any person except a purchaser for fair consideration without knowledge of the fraud at the time of purchase: (i) have the conveyance set aside to the extent necessary to satisfy his claim; or (ii) disregard the conveyance and attach or levy execution upon the property conveyed. There is specific case authority holding, in circumstances indistinguishable from those presented here, that where, in consideration of love and affection, a debtor husband conveyed all of his property to his wife and

rendered himself insolvent, the conveyance could be set aside by the husband's creditors. (Widener v. Hartnett, 12 Cal.2d287 (1938)).)

Petitioner was aware of the fraudulent conveyance from Mr. _____ to his spouse. Thus, notwithstanding the consideration paid by petitioner for the assets contributed to it, the Board's compliance staff may make use of the remedies set forth in Civil Code Section 3439.09 to satisfy the subject liability. Finally, in that the conveyance from Mr. _____ to his spouse may be disregarded for sales and use tax purposes, petitioner can also be considered as the direct successor to the _____, i.e., the community property owners of the predecessor.

Recommendation

We recommend that the petition for reconsideration of successorship liability be denied.

John B. Adamo, Hearing Officer

Date

REVIEWED FOR AUDIT:

Principal Tax Auditor

Date