

M e m o r a n d u m**395.1000**

To: Marysville – Auditing (CB)

December 23, 1965

From: Tax Counsel (LWR)

Your memo dated November 15 asked our opinion on circumstances under which “P” entered into a contract with “A” to purchase “A”’s business. The contract provided for a valuation of the various assets of the business. The sales contract was executed and title passed on or about June 30, 1965. On October 15, 1965, an amendment to the contract was executed increasing the value of “good will” without changing the amount for the sale of the entire business. This had the effect of reducing the valuation of “other assets”, including tangible personal property, thereby reducing the measure of sales tax. Between the execution of the contract and the amendment, the sales tax liability on the sale was determined and billed. Now “P”, who agreed to pay the sales tax under the terms of the contract, is asking for a reduction in the tax billing.

It is our opinion that the audit should not be changed because of the subsequent amendment.

Our records indicate that this is a novel case and we have not had a prior opportunity to review an identical set of circumstances.

As you know, Ruling 81 provides that in the sale of a business, the tax applies to the gross receipts that represent the fair retail value of tangible personal property held or used in the course of an activity for which the seller is required to hold a seller’s permit. The sale by “A” to “P” seems to fit within Ruling 81.

The terms “fair market value” and “fair retail value” seem to be synonymous with their application under the Sales and Use Tax Law. Fair market value is generally defined as the price at which a willing seller and a willing buyer will trade. (Montrose Cemetary Co. v. Commissioner of Internal Revenue, 105 F.2d 238, 242.)

In Hawley v. Johnson, 58 Cal. App. 2d 232, the plaintiff complained that the book value, rather than the stated trade-in value of a traded in automobile should be used as the measure of sales tax in an automobile sales transaction. The agreement provided for a trade-in allowance of \$500 while the book value of the traded in car was only \$400. The \$100 difference was carried as an overallowance on the seller’s books. The seller’s contention would have had the effect of

reducing the total amount of the sale resulting in a reduced sales tax. The court pointed out that although the traded in car might be worth only \$400 on the open market, the parties to the transaction agreed on an allowance in the amount of \$500, and the amount of \$500 should be used in determining the measure of tax even though \$100 of that amount was listed as an overallowance on the books of the seller.

Although Hawley v. Johnson does not consider the later amendment of a sales agreement, it does imply that the sales price is established at the time the transaction occurs, and the sales agreement may be used to determine the value of the tangible personal property involved.

In the present case, it seems that the fair retail value should be the price at which the willing buyer, “P”, was willing to buy and the willing seller, “A”, was willing to sell, as established by their actions and agreement at the time the sale occurred. Obviously, they were both agreed on the value of the property at the time of sale.

On the other hand, there is no indication or evidence that the revaluation of “good will”, reducing the value of the assets, had any relation to a change in true value or fair market value of the “good will” or that the later valuation was any more precise than the original valuation.

Also, there are other factors to consider.

The sales tax liability is an obligation of the “retailer” and arises upon passage of title to the tangible personal property. The sales price was established at the time of sale when title passed on June 30, 1965, which was over three months before the amendment on October 15, 1965. Since the Board, as a third party, is not bound by the contract of the buyer and seller (Santa Clara Sand and Gravel Co. v. State Board of Equalization, 225 Cal. App. 2d 676), the amendment to the contract is not binding upon the Board’s determination. The Board, in using the terms of the contract to establish the “fair retail value” is not binding itself to the contract but simply recognizing its provisions to determine at what price the sale occurred, and what value the parties placed on the various assets at the time they were bargaining for the sale. Another factor, indecisive by itself but one which militates against the taxpayer’s position, is that there is no apparent consideration for the reallocation of value from “other assets” to “good will”. It is a concept old in the law that an agreement to change the terms of an existing contract is a separate contract within itself and must be supported with adequate consideration other than the consideration on which the original contract was based. (Maryland Casualty Co. v. First National Bank of Atlanta, Tex., 82 F.2d. 465, 467; In re Riff, 205 F. 409; Peachy v. Witter, 131 Cal. 316; George v. Bekins Van & Storage Co., 33 Cal. 2d at 855.) At the same time, the promise to perform an obligatory act or an existing duty is not consideration. The party promising such performance is not giving anything new to the person getting the promise. This concept is equally old in the law. (Moore v. Bartholomae Corp., 69 Cal. App. 2d 474; Tipton v. Tipton, 133 Cal. App. 500; Avery v. Schuman Co., 159 F. Supp. 907; and Section 1605 California Civil Code.)

In the contract before us, under paragraph 2(b) the buyer agrees to collect the seller's accounts receivable for a 90-day period and deliver to the seller all uncollectible accounts that the buyer does not purchase. In the letter of September 29, 1965, from "A"'s attorney, it appears that the only consideration for the reallocation is the promise of the buyer to do what he was obligated to do under the original contract. Therefore, it appears that the only consideration for the amount is the promise to perform an existing obligatory act or duty.

There is no reason for the Board to agree that the amendment represents the fair retail value of the "good will" or "other assets" when the amendment does not represent the value at which title to the property was passed, nor the value which was bargained for by the parties. This is particularly true when the amendment does not have the apparent dignity of an enforceable contract between the parties.

If an alternative standard is offered that is more reasonable than the terms of the agreement between the buyer and seller at the time of sale, it should be given consideration, but under the circumstances of this case, no such alternative standard has been offered and the audit should remain unchanged by the October 10, 1965 amendment.

WLR:em [1b]