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8/23/94

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:)	DECISION AND RECOMMENDATION
Petitioner)	

The Appeals conference in the above-referenced matter was scheduled for April 14, 1994 by Staff Counsel Lucian Khan. However, on April 8, 1994, petitioner's representative, , requested that the conference be canceled and the matter handled by way of brief. A brief dated April 21, 1994 has been submitted.

Representing Petitioner:

Representing the Sales and Use Tax Department:

Protested Item

The protested tax liability for the period October 1, 1987 through June 30, 1988 relates to the sale of business assets measured by $1,547,420.

Contentions

1. Since petitioner still remained responsible for its liabilities after the business assets were transferred to its subsidiary, no benefit was conferred. Accordingly, there was no consideration and thus no sale.

2. If it is found that a sale did occur, then the measure should be reduced by the amount of the contingent liabilities.

3. Because there was a later rescission, a sale did not legally take place.

Summary

Petitioner is a corporation which has two major divisions. The equipment division manufactures and leases equipment to the food industry, and the food division manufactures food packaging materials and cans. On January 1, 1988, petitioner transferred certain assets and liabilities to its commencing wholly owned subsidiary corporation,) in exchange for 99 shares of common stock, which represented 100 percent of 's outstanding shares. In October 1988, the activities of were apparently merged back into petitioner. In a later audit, the Sales and Use Tax Department (SUTD) auditor determined the transfer of business assets from petitioner to was a taxable transaction, and assessed tax accordingly.

In its original petition dated February 28, 1991, petitioner argued that because it remained jointly liable with for all debts and actually made payments to the creditors, there was no consideration, and thus no sale according to the holding in <u>Macrodyne Industries, Inc.</u> v. <u>State Board of Equalization</u> (1987) 192 Cal.App.3d 579; 237 Cal.Rptr. 537. In the brief dated April 21, 1994, petitioner acknowledges that the California Supreme Court in <u>Beatrice Company</u> v. <u>State Board of Equalization</u> (1993) 6 Cal.4th 767; 863 P.2d 683, specifically overturned <u>Macrodyne</u> (to the extent it is inconsistent). Petitioner still wishes to preserve this argument for later appeal, however, and also argues that because the transfer to was later rescinded, and was merged back into petitioner, legally petitioner could not be held liable for sales tax on the earlier transfer. Finally, petitioner argues that if it is determined that a taxable sale took place, the measure should be reduced by the amount of the contingent liabilities which were incorrectly included in the auditor's calculations, and are as follows: (1) pension reserves totaling $38,225; (2) workman's compensation reserves totaling $172,390; and (3) plant rationalization reserves totaling $916,472. These three items are not debts or liabilities since they are not fixed and rely upon future events, which are speculative.

In the April 21, 1994 brief, petitioner requested an additional 30 days in which to submit documentation supporting the above arguments. No further documentation was submitted.

Analysis and Conclusions

Based on the evidence and facts submitted, we conclude that petitioner made a taxable transfer of its assets to . Revenue and Taxation Code Section 6006 defines a "sale" to mean and include any transfer of title or possession of tangible personal property for a consideration. As petitioner has acknowledged, in the Beatrice case (supra), an assumption of indebtedness constitutes consideration. Sales and Use Tax Regulation 1595(b)(4) provides that tax does not apply to the transfer of property to a commencing corporation solely in exchange for a first issuance of stock of the commencing corporation; however, if there is an assumption of indebtedness, the transfer does not qualify for the exemption.

The fact that certain liabilities were contingent does not entitle petitioner to a reduction in the measure of tax. Since it is probable that future events will occur confirming the fact of the contingent liabilities, 's assumption of the liabilities is consideration given for the assets transferred. However, if it can be proven that any of the liabilities arose after the transfer and was for the benefit of , this would not constitute consideration.

Petitioner has submitted no proof that the earlier transfer was rescinded, and even if it was, petitioner has not satisfied the requirement of promptness (Cal. Civil Code Section 1691; Eade v. Reich (1932) 120 Cal.App. 32, 7 P.2d 1043). A merger nine months later does not constitute a rescission.

Recommendation

Deny the petition.

Lucian Khan, Staff Counsel

5-23-94

Date