

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
C--- S--- CORPORATION)	No. SY – XX XXXXXX-010
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Stephen A. Ryan on February 9, 19XX in Hollywood, California.

Appearing for Petitioner:	Ms. S--- R---
	Senior Accounting Specialist
	Mr. D--- L---
	Manager, State & Local Taxes

Appearing for the Sales and Use Tax Department:	Mr. Raul Gonzales
	Supervising Tax Auditor

Protested Item

The protested tax liability for the period April 1, 198X through December 31, 199X is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Unreported gross receipts from the sale of furniture and equipment to I--- I--- N--- Services, Inc.	\$X,XXX,XXX

Petitioner's Contentions

1. The measure of tax is zero; thus, there is no sales tax.
2. If tax applies, the measure is too high.

and included it in the liabilities assumed because the auditor represented that Mr. G--- B---, as the tax manager of the subsidiary, told the auditor that such receivable had only been created by petitioner and the subsidiary at the time of the sale as additional consideration for this transfer. At the conference, Mr. L--- questioned this \$6,903,000 change by the auditor. Mr. L--- was asked to explain, but could not since he had not been involved in the transaction. He was allowed time to submit information after the conference, but he merely submitted the records used by the auditor. These various records of the division and of the subsidiary, each dated April 1, 1988, do not by themselves clarify either that there had been an existing receivable of petitioner prior to April 1, 1988, or that Mr. B---'s explanation was right or wrong.

Mr. L--- contends that none of the liabilities which the subsidiary assumed was attributable to any tangible personal property transferred. He argues that although there was consideration for the sale, such consideration is all attributable to the intangible rights also transferred. He thus believes that the measure of sales tax on the transfer of the tangible personal property is zero. Mr. L---'s position is that there must be a direct relation between a particular liability and a specific asset in order to be "attributable". He believes that any indirect connection, such as the \$3,604,783 "accrued payroll" liability for the employees who used the computers, furniture, etc., is insufficient to be "attributable".

Mr. L--- represented that there were no specific liabilities attached to any of the transferred tangible personal property assets in question, such as would be evidenced by a UCC-1 filing with the California Secretary of State. However, he did not know the details of the "note payable-affiliate" or "miscellaneous other liabilities" obligations assumed by the subsidiary.

A zero sales tax measure was suggested by Mr. L--- in the following hypothetical case: a retailer transfers equipment to a person, in exchange for the transferee's assumption of the retailer's liabilities which were specifically attached to a nontangible personal property asset such as real estate.

Analysis and Conclusions

What is the measure of the sales tax?

Sales tax is imposed upon a retailer measured by the gross receipts which he or she derived from California retail sales of tangible personal property (Revenue and Taxation Code section 6051). "Sale" is defined as the transfer of title or possession of that property for consideration (Rev. & Tax. Code § 6006(a)). "Consideration" for Sales and Use Tax Law purposes is defined in Civil Code section 1605 as follows:

"Any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of

consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise." (Emphasis added.)

"Gross receipts" is defined to mean the total amount of the sale price of the retail sales of retailers, valued in money, whether received in money, cash, credit, property, or otherwise (Rev. & Tax. Code § 6012(a), (b)(2)). However, gross receipts must be provided as consideration for the property sold, rather than be provided for some other reason (Szabo Food Service, Inc. v. State Board of Equalization (1975) 46 Cal.App.3d 268, 272-273).

The California Supreme Court has recently held that there is a measurable valuable consideration which is subject to sales tax as the result of the California retail sale of tangible personal property assets from a parent corporation's spin-off of one of its divisions to a commencing wholly owned subsidiary corporation in exchange for the subsidiary's first issue stock plus the subsidiary's assumption of the liabilities of that division (Beatrice, supra). The assumption was held to have "value equal to the cost to the promisor of paying its debts or fulfilling its obligations" (Beatrice, at p. 783). Further, the court in Cal-Metal Corp. v. State Board of Equalization (1984) 161 Cal.App.3d 759, 764-765, opined generally as follows regarding a similar situation:

"The assumption of liability owed by a transferor of property can constitute the consideration for the transfer. That consideration is the measure of the sales price and thus the measure of the ultimate tax liability."

However, in that situation, the liabilities which were assumed were "the liabilities on the equipment" (Cal-Metal, supra, p. 762). Petitioner believes this factor is critical. On the basis that the purchaser had assumed "all" the liabilities, the Cal-Metal court rejected that taxpayer's argument to allocate only 50 percent of the liabilities (pp. 768-769).

In United States Lines, Inc. v. State Board of Equalization (1986) 182 Cal.App.3d 529, the court upheld the sales tax on the transfer of cranes in exchange for the full value of the purchaser's execution of a separate lease agreement whereby the purchaser leased those cranes back to the seller. Thus, the consideration for the sale was a separate agreement itself.

Here, the Department has not used as the measure of sales tax the full \$24,650,711 (\$17,747,711 plus \$6,903,000) amount of liabilities which were assumed by the subsidiary. This is because petitioner also then sold real property and intangible rights, and the Board does not impose sales tax on consideration paid for those rights. The Department has merely attempted to make a reasonable allocation of that \$24,650,711 total to the total \$45,821,337 assets transferred such that California sales tax is only imposed upon an amount representing the valuable consideration paid for the tangible personal property assets located in California when transferred. The Department could have used the \$3,044,027 net book value of

such taxable assets, but did not. It reasonably used only a \$1,637,609 measure as a result of its Audit Manual formula.

We reject petitioner's proposed method of establishing the sales tax measure. Petitioner desires an unreasonable allocation which would attribute zero to those tangible personal property assets which were located in California when transferred. The substance of petitioner's contention is that there was no consideration attributed to such property because all the consideration involved in the transfer was attributable to the other property (nontangible) also transferred.

This analysis ignores both the substance of what took place and the applicable laws. Petitioner and the subsidiary made an agreement and then acted in accordance with it. They made one sale of \$45,821,337 worth of assets in exchange for the subsidiary's first issue stock plus the subsidiary's promise to assume \$24,650,711 of petitioner's liabilities. The parties did not allocate any particular debt amount to any specific asset. As in Cal-Metal, the subsidiary assumed all the liabilities in consideration for receipt of all the assets. That amount is consideration for all the assets transferred, including the tangible personal property assets located in California. The law in the case of an assumption of liabilities given in exchange for assets does not limit the taxable consideration only to those liabilities, if any, which were directly attached to the specific tangible personal property asset(s) in question.

In the absence of any other more reasonable allocation under these circumstances, we find that \$1,637,609 is the consideration paid for the assets in question and, thus, constitutes the measure of petitioner's resulting sales tax liability.

Without evidence to support Mr. L---'s allegations about the \$6,903,000 amount, we uphold the auditor's findings and conclusions based upon his actual examination of petitioner's records and specific explanations from the subsidiary's tax manager. To obtain an adjustment, petitioner will need to submit satisfactory evidence to support its position.

Recommendation

Redetermine without adjustment.

Stephen A. Ryan, Senior Staff Counsel

Date

w/Exhibit 1