

395,2546 (4 pgs)

7-11-94

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

~~_____~~

No. ~~_____~~

Petitioner

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel Stephen A. Ryan on May 18, 1994 in Sacramento, California.

Appearing for Petitioner:

Attorney

Appearing for the
Sales and Use Tax Department:

Mr. Scott Lambert
Supervising Tax Auditor

Protested Item

The protested tax liability for the period October 1, 1988 through December 31, 1991 is measured by

<u>Item</u>	<u>State, Local and County</u>
E. Unreported gross receipts from retail sale of equipment to a subsidiary	\$511,404

Petitioner's Contentions

1. No tax applies since no "sale" occurred because there was merely a capital contribution without consideration.
2. Regulation 1595(b)(4) makes the transfer exempt.

Summary

Petitioner was engaged in a business which included leasing equipment, and then selling that equipment. It was a subsidiary of the _____ had been the corporate president when this current audit was conducted. The Board had previously audited petitioner for a period which ended on June 30, 1988.

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Petitioner transferred ownership in various assets to ██████████, a newly formed, wholly owned subsidiary. The assets included numerous pieces of equipment which were subject to leases by petitioner to numerous lessees. Some of this equipment had been purchased tax-paid by petitioner. That transfer by petitioner was evidenced by a May 1, 1989 Assignment of Assets Agreement with ██████████. It provided that petitioner's transfer of all its rights in the equipment and the leases was "a capital contribution". Petitioner also received shares of stock in the subsidiary. The equipment was not encumbered at the time of the transfer, and constituted less than 80 percent of all the property held or used by petitioner in the course of its activities.

In addition to bookkeeping entries made by petitioner and the subsidiary to record petitioner's investment in the subsidiary (as capital stock, and additional paid-in surplus), and for other items such as the transfer of the lease receivables, lease residuals, and property tax receivables, petitioner also recorded a "note receivable" and the subsidiary recorded a "note payable" to petitioner for \$3,458,065.70. The auditor found that this amount was the net adjusted tax basis for all the real and tangible property transferred, with \$511,404 representing the price of the tangible personal assets located in California. No promissory note was prepared. It appears that no entries were made in the "intercompany" accounts of either party.

In a March 23, 1989 document entitled ██████████ Board Of Directors Special Meeting, petitioner's directors had previously indicated their desire to "segregate a specified portion of [its] lease receivables into the newly created subsidiaries". The Department contends that petitioner's reason for the transfer was an attempt to avoid potential lawsuits against it due to fuel leaks from some underground tanks which were also transferred. The Department alleges that petitioner obtained a February 28, 1989 tax opinion from an attorney which indicated the reason for recording a note payable and receivable was to show legitimacy to the transfer of the leaking fuel tanks in case someone later questioned that transfer as a sham in an improper attempt without consideration for petitioner to avoid liability for the damage from leaking tanks.

After notice of the transfer was provided to the lessees, rental payments were made to the subsidiary, but it thereafter transferred the same amounts to petitioner. The subsidiary and petitioner also reduced the "note payable" and "note receivable" accounts according to those payments by the subsidiary to petitioner. The subsidiary continued to pay petitioner the amount of rental receipts after the "note payable"

and "note receivable" accounts were reduced to zero, and those amounts were accumulating in those accounts when the audit was conducted. Petitioner's representatives indicated to the auditor that those excess amounts would be treated as dividends.

described the bookkeeping entries as merely evidencing petitioner's internal allocation of a portion of its outstanding indebtedness. He labelled the subsidiary's subsequent payments to petitioner as a "return of capital contribution". His understanding was that petitioner's avoidance of potential lawsuits was only one reason for the transaction. He represented that he had not been involved with petitioner at the time of these actions, but the above-mentioned directors meeting record identified as having taken the minutes for that meeting.

Analysis and Conclusions

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 to include the transfer of title to 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."

"Gross receipts" is defined to mean the total amount of the sale price of retail sales of retailers, valued in money, whether received in money, cash, credit, property or otherwise (Rev. & Tax. Code § 6012(a), (b) (2), and (b) (3); and N.W. Pac. R.R. v. State Board of Equalization (1943) 21 Cal.2d 524, 526, 529-530). When property is sold on credit, unless otherwise excluded, the whole amount of the contract is taxable (Regulation 1641(a)). Without valuable consideration, the transfer of tangible personal property does not constitute a "sale" (Wallace Berrie & Co. v. State Board of Equalization (1985) 40 Cal.3d 60, 67). A capital contribution does not result in a sales or use tax liability (Business Taxes Law Guide Annotations 395.1800 [1/7/53], and 395.1860 [7/31/50]).

We conclude that the transfer of title to the assets involved was valuable consideration sufficient for a "sale". The substance of the exchange was not a capital contribution because the parties voluntarily created a new "note" liability from the subsidiary to petitioner. Contrary to [redacted] contention, the evidence shows that the parties intended at the time of the exchange that the subsidiary would pay petitioner on that "note" in order to create legitimate consideration to avoid a mere sham transfer. That is a legitimate business reason. The California Supreme Court in N.W. Pac. R.R., supra, has even held that sufficient consideration existed for a taxable "sale" solely from "credits" evidenced by bookkeeping entries and in "intercompany bill collectible" and "intercompany voucher payable" documents, although there was no intent for the parent-transferor corporation to pay cash to the subsidiary-transferor because there was a credit to the open book account between them (pp. 526 and 529-530). These accounts and amounts were not mere book entries with no meaning as alleged by petitioner. Further, the subsidiary actually paid petitioner on the note payable.

Lastly, [redacted] appears to have been involved in the transfer in question. He was requested to explain in detail these actions, plus to supply the accounting manuals and examples of other intercompany transactions of the various related companies in the [redacted] family so that we could better understand what occurred. Nothing has been received.

Regulation 1595(b)(4) does not create a nontaxable status of the exchange since petitioner received the consideration consisting of the subsidiary's promise or implied promise to pay petitioner on the note payable/note receivable.

Recommendation

Redetermine without adjustment.

Stephen A. Ryan
Stephen A. Ryan, Senior Staff Counsel
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Date