

Add Section 6812.1 to, and amend Section 6814 of, the Sales and Use Tax Law to allow the Board the ability to assess successor's liability when a business is transferred between related persons, as defined.

Source: Sales and Use Tax Department

Existing Law

Under the Sales and Use Tax Law, the Board may collect the tax from the business that incurs the liability. There are times when a business is sold in an arms length transaction wherein the parties retain an escrow company to hold funds in trust pending the satisfaction of the conditions of the sale. In other cases the parties may not utilize a third party and may deal directly with each other using a contract or not. Some parties take the assumption of the tax liability into consideration and reduce the purchase price by a corresponding amount. Still in other cases, some businesses are transferred between related parties in an effort to avoid payment of taxes or fees. The current statutory provisions do not sufficiently address the transfer of a business between related persons.

Under existing law, the Board's Sales and Use Tax Department (SUTD) has been able to utilize Revenue and Taxation Code, Division 2, Part 1, Chapter 6, Article 7, Payment on Termination of Business and Successor's Liability (Sections 6811 through 6815), to require the seller or predecessor and purchaser or successor to address a sales tax liability owed by the seller. The purchaser is required to withhold sufficient monies of the purchase price to cover any amount of taxes due unless the former owner produces a receipt (Certificate of Tax Payment) from the Board showing that the tax has been paid or a certificate stating that no amount is due. Otherwise, the successor becomes liable for payment of the amount, to the extent of the purchase price valued in money. The "Certificate of Tax Payment" or Tax Clearance is normally handled through escrow, and in most cases is a condition of the escrow. The process is a proactive effort, on the part of the seller, to make available to the Board the proceeds of the sale of the business. In those cases where the purchaser or seller fails to produce a Tax Clearance, or the purchaser fails to withhold the amount of the liability, to the extent of the purchase price, or the purchaser assumes certain liabilities, then the law allows the Board to extend to the purchaser of a business the liability of the seller. This is known as successor's liability.

This Proposal

This proposal would allow the SUTD the ability to pursue collection of a liability from the successor when the business has been transferred between related persons, as defined, for the purpose of evading payment.

The purpose of this proposal is to address a current loophole in the sales tax law by addressing transfers of businesses made between related persons, as defined, so that a business can not be transferred for the purposes of evading payment of the tax, which is known as “churning” business ownership. Churning is a practice wherein a debtor transfers ownership of the business for little or no consideration for the purpose of shielding the assets of the business from creditors. By clouding ownership of the business, the debtor can continue to operate their business without paying liabilities owed to the Board.

SUTD surveyed their district offices for examples of cases in which a business was transferred between related persons, as defined in the proposal, and in which there was no tax clearance processed, and there was no ability to pursue the succeeding business for payment of the predecessor’s liability. These also excluded transfers such as assignments for the benefit of creditors, foreclosures of mortgages, or sales by trustees in bankruptcy. There were 64 accounts identified with outstanding liabilities for the predecessor business of \$11.8 million. The following are examples of the related transfers:

- A sole proprietor auto dealer closed his business and incorporated with himself as the corporate officer. He continued to operate at the same place of business with a similar business name. The preceding business has a fraud audit liability of \$1.8 million and the succeeding business also incurred a separate fraud audit liability for \$1.9 million. There was no sale of the business and the liability for the predecessor could not be pursued against the successor.
- An individual operated a car cover business and incurred a liability of \$334,423. After being pursued for collections the individual incorporated and continued to operate at the same place of business. He went on to incur an additional \$27,257 in liabilities and continues to operate free from the preceding business’ liability.
- A sole proprietor retailer of boats incurred a liability of \$195,782, with an additional \$467,437 currently in petitions. The individual incorporated his business, continues to operate at the same location, and went on to incur an additional \$63,948 in liability. The Board would be unable to pursue successor’s liability without the proposed language.

Section 6812.1 of the Revenue and Taxation Code is added to read:

(a) Notwithstanding Section 6811, if the business or stock of goods is transferred or assigned to a related person, the related person shall be deemed to have assumed all of the liabilities of the predecessor under this part.

(b) The transfer is deemed to be to a related person if:

1. The predecessor and the successor are owned or controlled by the same persons.
2. The predecessor and the successor are related as parent and child, siblings, cousins, or aunt or uncle and niece or nephew.
3. The successor was a partner of the predecessor.
4. The transfer is, in fact, a consolidation or merger that includes the predecessor.
5. The successor is a mere continuation of the predecessor, where the predecessor no longer exists and only the successor remains and there is an identity of stock, stockholders, and directors between the predecessor and the successor.
6. The successor is a substantial continuation of the predecessor, which may include, but is not limited to:
 - (A) retention of the same employees;
 - (B) retention of the same supervisory personnel;
 - (C) retention of the same production facilities in the same physical location;
 - (D) production of the same product;
 - (E) retention of the same name;
 - (F) continuity of assets;
 - (G) continuity of general business operations;
 - (H) continuity of customers; and
 - (I) the successor is holding itself out as the continuation of the predecessor.
7. Inadequate cash consideration was paid for the predecessor's assets.
8. Less than fair market value was paid for the predecessor's assets.
9. The sale was fraudulently made with the intent to escape the tax liability imposed under this part.

Section 6814 of the Revenue and Taxation Code is amended to read:

(a) The obligation of the successor shall be enforced by serving a notice of successor liability on the person. The notice shall be served in the manner prescribed for service of a notice of a deficiency determination, not later than three years after the date the board is notified of the purchase of the business or stock of goods or the transfer of the business. The successor may petition for reconsideration in the manner provided in Article 5 (commencing with Section 6561) of Chapter 5 of this part. The notice shall become final and the

amount due and payable in the manner provided in that article except that no additional penalty shall apply if not paid when due and payable. The provisions of this chapter with respect to the collection of any amount required to be paid under this part shall apply when the notice becomes final.

(b) (1) If the board finds that a successor's failure to withhold a sufficient amount of the purchase price to cover the amount owed by the former owner is due to reasonable cause and circumstances beyond the successor's control, and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect, the successor may be relieved of any penalty included in the notice of successor liability.

(2) Any successor seeking to be relieved of the penalty shall file with the board a statement under penalty of perjury setting forth the facts upon which he or she bases his or her claim for relief.