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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	CORPORATION FRANCHISE TAX APPEAL
ASTRA OIL COMPANY, INC.	Case No. 609368

Year	Deficiency Amount
2004	$154,630
2005	$87,964

Representing the Parties:

For Appellant: Scott D. Newman, K&L Gates LLP

For Franchise Tax Board: Craig Swieso, Tax Counsel IV

QUESTION: Whether appellant is liable for proposed deficiency assessments for appellant's portion of its combined reporting group's California-sourced apportionable business income.

HEARING SUMARY

Background

During the years in issue, appellant was a member of a unitary combined reporting group that included Astra Holding USA, Inc., which is now known as Pasadena Refining System, Inc. (New PSRI). New PSRI was designated as appellant's key corporation and, as such, was an agent and surety with respect to appellant's tax liability for the years in issue. After respondent commenced an examination of the group return, New PSRI notified respondent in writing that it was terminating its

role as the key corporation for appellant and, as a result, New PRSI was no longer an agent for appellant but remained a surety with respect to appellant's tax liabilities for the years in issue. On October 12, 2009, respondent issued Notices of Proposed Assessment (NPAs) to appellant and on December 10, 2009, appellant filed a protest. After a protest hearing, respondent sustained the adjustments upon which the NPAs were based. On March 23, 2012, respondent issued Notices of Action (NOAs) to appellant from which appellant filed this timely appeal. (Resp. Opening Br., pp. 1-2.)

ISSUE: Whether appellant is liable for proposed deficiency assessments for appellant's portion of its combined reporting group's California-sourced apportionable business income.

Contentions

Appellant

Appellant[1] states that the proposed deficiencies are not in dispute but contends that respondent should recover the deficiency amounts from New PSRI rather than appellant as the party "properly responsible for the payment". Appellant states that, prior to September 1, 2006, Astra Oil Trading NV (AOT NV) owned all of the stock of Astra Holding USA, Inc.,[2] and owned all of the shares of appellant. On or about August 31, 2006, appellant was merged into Astra Oil Company LLC (Astra LLC), a newly formed limited liability company. Appellant states that, on September 1, 2006, New Astra distributed as a dividend virtually all of its tangible property, consisting principally of inventory and accounts receivable, to New PSRI. Also on September 1, 2006, AOT NV sold 50 percent of the stock in New PSRI to Petrobras America, Inc. (PAI), a wholly-owned subsidiary of a Brazilian government-controlled oil company. At the time of the sale, New PSRI owned all of the inventory and accounts receivable of Astra LLC as well as a refinery in Texas formerly owned by a wholly-owned subsidiary of New PSRI. Finally, on September 1, 2006, AOT NV contributed all of the membership interests in Astra LLC to Astra Energy Holdings, Inc., the domestic parent of a different group of Astra companies. (Appeal Letter, pp. 1-2.)

[1] Appellant is also referred to as "Astra Oil" at various places in this hearing summary for purposes of clarity.

[2] Consistent with appellant's usage of these names, Astra Holding USA, Inc. is referred to as both "New PSRI" and as "Astra USA" at various places in this hearing summary.

Appellant states that "controversies" subsequently developed between the Astra and Petrobras parties which led to litigation that continues to this day. In April 2009, an arbitration panel determined that the Astra parties had exercised their rights to put the remaining 50 percent interest in New PSRI to PAI and that PAI was required to purchase that interest for approximately $295 million. Appellant states that the Astra parties transferred their interest to PAI but that PAI has not tendered payment and is contesting the arbitration award. Because New PSRI was the transferee of virtually all of Astra LLC's tangible assets on September 1, 2006, appellant asserts that New PSRI is responsible for the payment of the proposed additional tax. (Appeal Letter, p.2.)

In an opening brief, appellant restates its argument that New PRSI is liable for the additional tax because: (1) Astra LLC distributed to New PRSI as a dividend and for no consideration virtually all of its tangible assets with a fair market value of approximately $108 million; (2) New PRSI made a group return election and designated New PRSI as the "key corporation" for 2004 and 2005; (3) California's rules relating to the income taxation of corporations generally conform to the federal rules and holding Astra LLC liable for the proposed additional tax would result in a "serious deviation" from the federal rules; and (4) on June 29, 2012, PAI and certain of its affiliates entered into a settlement agreement with Astra LLC and certain of its affiliates under which PAI, which has been the sole shareholder of New PRSI since April 2009, and its affiliates agreed to hold harmless Astra LLC and its affiliates from the proposed tax deficiency for 2004 and 2005. (App. Op. Br., pp. 2-3.)

Appellant restates the facts presented in the appeal letter but adds that, in March of 2006, Petroleo Brasileiro S.A. (Petrobras-Brazil), the Brazilian national oil company, entered into a Stock Purchase and Sale Agreement and Limited Partnership Formation Agreement (March 2006 SPA) with AOT NV and Astra Oil, as seller, which contemplated the following: (1) AOT NV would sell 50 percent of the issued and outstanding stock of Astra USA to Petrobras-Brazil or an affiliate such as PAI, its wholly-owned subsidiary, which would then change its name to New PRSI; (2) New PRSI's principal asset would be the Pasadena Refinery; and (3) the Astra parties and the Petrobras parties would form a limited partnership to acquire and supply crude oil and feedstocks to be refined by New PRSI and the marketing, distribution, and sale of New PRSI's refined products and the limited partnership would act as "the principal for its own account and bear all of the trading risks in

connection with both the acquisition of the crude oil and feedstocks to be refined and the marketing, distribution and sale of the refined products." As a result of this arrangement, appellant states that New PRSI was to bear no trading risks and was to receive a processing fee from the limited partnership for its refinery services.

Appellant further states that, in order to effect the transactions contemplated by the March 2006 SPA, a restructuring of Astra USA took place on September 1, 2006 as follows:

- Astra Refining System, Inc. (ARSI), a holding company that wholly owned Old PRSI and was itself wholly owned by Astra USA, was merged upstream into Astra USA.
- Old PRSI, a corporation that owned and operated an oil refinery in Pasadena, Texas, was merged upstream into Astra USA, thus making Astra USA the direct owner of the Pasadena Refinery.
- Astra Oil was merged into Astra LLC which was wholly-owned by Astra USA.
- Astra LLC distributed as a dividend virtually all of its tangible assets with a value of approximately $108 million.
- Astra USA distributed all of its membership interests in Astra LLC and Astra Power to AOT NV, which then contributed those interests to Astra Energy, a corporation wholly-owned by AOT NV.
- Astra USA changed its name to New PRSI.

Upon the completion of the restructuring:

- AOT NV sold 50 percent of the New PRSI stock to PAI.
- Astra Energy and PAI formed a limited partnership, PRSI Trading Company LP (PRSI Trading), for the purposes noted above, and Astra Energy and PAI each formed two wholly-owned subsidiaries to hold general and limited partnership interests in PRSI Trading. (App. Op. Br., pp. 5-6.)

Appellant states that the Astra partners and the Petrobras partners each contributed $54 million to PRSI Trading, which PRSI Trading used to purchase the assets (principally accounts receivable and inventory) from New PRSI that had been distributed to New PRSI from Astra LLC. Appellant asserts that, upon the completion of the foregoing steps, the sale by AOT NV of 50 percent

of the stock of New PRSI to PAI, and the formation and capitalization of PRSI Trading, New PRSI was the direct owner of the Pasadena Refinery and held approximately $108 million to finance its refinery operations. Appellant further states that, after the steps were completed, the Astra parties and the Petrobras parties became involved in "serious controversies" concerning New PRSI and PRSI Trading and that the parties went to arbitration which was concluded in April 2009. Appellant states that the arbitration panel issued an award in favor of the Astra parties under which the Astra parties were to transfer their 50 percent interest in New PRSI and their 50 percent partnership interest in PRSI Trading to PAI and Petrobras Partners, respectively, and in exchange PAI and Petrobras Partners were required to pay the Astra parties the sum of approximately $465 million. (App. Op. Br., pp. 7-8.)

Appellant states that the Astra parties' interests were transferred but that the Petrobras parties contested the award and did not pay the purchase price. Appellant states that the parties then litigated the Astra parties' recovery of the purchase price and the recovery of loans made to PRSI Trading by Astra LLC and AOT NV. Appellant states that, on June 29, 2012, the parties entered into a settlement agreement and a mutual general release under which Petrobras and PAI, jointly and severally, agreed to "indemnify and hold harmless the Astra Parties of and from any and all liability in connection with the Tax Disputes released herein." Appellant further states that the "Tax Disputes" includes the "Second California Tax Claim" as defined in a letter dated September 1, 2011, from PAI's general counsel to AOT NV and Astra Oil. Appellant states that the letter describes respondent's proposed deficiency assessments at issue for the 2004 and 2005 tax years, estimated at approximately $272,518, which included a payment of $10,698 by New PRSI for a tax deficiency of Astra Power. Appellant contends that the settlement agreement makes clear that Petrobras and PAI, jointly and severally, agreed to pay on behalf of New PRSI the proposed additional assessments against Astra Oil for the 2004 and 2005 tax year. (App. Op. Br., pp. 9-10.)

Appellant argues that New PRSI is liable as a transferee for the proposed assessment of additional tax against Astra Oil for 2004 and 2005 for the following reasons:

- Following the merger of appellant into Astra LLC, Astra LLC distributed virtually all of its tangible assets to New PRSI for no consideration.
- Thereafter, when New PRSI spun off the Astra LLC membership interests to AOT NV, Astra

LLC held virtually no tangible assets and was a "shell" although it engaged in oil trading activities.

Appellant asserts that Internal Revenue Code (IRC) section 6901 and the Treasury Regulations thereunder provide for the assessment and collection of federal income taxes from "the transferee of the taxpayer which incurred the liability." Appellant also cites R&TC section 19071 which provides that respondent may assess taxes against "any person" who is liable for the taxpayer's obligations and R&TC section 19073 which provides specific procedures applicable to transferees and fiduciaries. Appellant further cites former R&TC section 25701, subdivision (a)(1), which provided for the assessment of a liability against a transferee. Appellant concludes that as a result of Astra LLC's distribution of assets to New PRSI, which New PRSI quickly converted into cash, New PRSI should be held liable for the proposed deficiency assessments for 2004 and 2005. (App. Op. Br., pp. 11-12.)

Appellant further argues that New PRSI is liable as a surety or guarantor because Astra USA (which is now New PRSI) elected to file a group or combined return with its subsidiaries, including Astra Oil, for the 2004 and 2005 and designated itself as the "Key Corporation" pursuant to California Code of Regulations, title 18, section (Regulation) 25106.5-11. Appellant contends that PAI and New PRSI "had long been aware" of respondent's audit of the 2004 and 2005 tax years and that the auditor would propose adjustments to Astra Oil's allocation and apportionment factors when Astra LLC presented them with the auditor's preliminary report in July of 2009. When New PRSI received the report, appellant states that New PSRI terminated the group return elections for 2004, 2005, and 2006 in an effort to protect itself from liability for the Astra Oil proposed assessments for 2004 and 2005. Thus, appellant contends that New PRSI terminated the group return election just as the audit was being concluded. (App. Op. Br., pp. 11-12.)

Appellant states that Astra Energy, in a letter to respondent dated August 17, 2009, objected to New PRSI's termination of the group return election for 2004, 2005, and 2006, but, respondent accepted the termination. Regardless of respondent's acceptance of the termination, appellant contends that New PRSI remains a guarantor or surety for Astra Oil's franchise taxes for 2004 and 2005 under Regulation 25106.5-11, subdivision (d)(3), because it designated itself a "Key Corporation" for those years. Appellant also notes that the Schedule R-7 states that "[t]he key

corporation agrees to act as surety and agent for each member of the group." (App. Op. Br., pp. 13-14.)

Appellant contends that respondent's attempt to hold Astra LLC liable for the proposed additional taxes is a departure from conformity with federal income tax laws. Appellant asserts that, when a domestic parent corporation causes a wholly-owned domestic subsidiary to merge into or convert from a corporation to a domestic LLC which is also wholly-owned by the parent corporation, the transaction is treated for federal income tax purposes as a tax-free liquidation of the corporate subsidiary into its parent pursuant to IRC sections 332 and 337. Appellant further asserts that this treatment results from Treasury Regulation section 301.7701-3(b)(1)(ii), in which a single member domestic LLC is treated for federal tax purposes as a disregarded entity unless an election is made to treat the LLC as a corporation. In this case, appellant states that no such corporation election was made. Thus, appellant concludes that, by merging into Astra LLC, Astra Oil was deemed to have liquidated into its parent corporation Astra USA and, by that deemed liquidation, Astra USA is treated as having received and succeeded to all of Astra Oil's assets and liabilities and tax attributes under IRC section 381. As a consequence of the deemed liquidation of Astra Oil into Astra USA, appellant contends that the distribution of assets and liabilities by Astra LLC to Astra USA had no further tax effect because Astra USA was already deemed to own those assets and liabilities. (App. Op. Br., pp. 14-15.)

Rather than applying California tax law, appellant contends that respondent applies the Delaware Limited Liability Company Act (LLC Act) in order to hold Astra LLC liable for the proposed deficiency. In this regard, appellant maintains that respondent takes the position that Astra LLC should be responsible for Astra Oil's proposed assessments because Astra LLC succeeded to all of Astra Oil's assets and liabilities pursuant to the LLC Act. Appellant contends that respondent is looking to the "form" of the transaction rather than the "substance" and thereby, uses the LLC Act to trump federal and state tax laws which require that the merger of Astra Oil into Astra LLC should be treated as a deemed liquidation of Astra Oil into New PRSI. Consequently, appellant argues that this position undermines California's practice of conformity with federal tax laws. (App. Op. Br., pp. 16-17.)

Appellant states that it is very likely that Petrobras and PAI would pay the proposed deficiency assessment against Astra LLC under the provision of the settlement agreement whereby

Petrobras and PAI agreed to indemnify the Astra parties, including Astra LLC, for tax liabilities for 2004 and 2005. Appellant further states its understanding that respondent's failure to attempt to collect payment from New PRSI or PAI, which are located outside California, is a matter of convenience to respondent because it is easier to pursue Astra LLC which operates in California. Appellant contends that this action discriminates against an in-state taxpayer. (App. Op. Br., pp. 18-19.)

In a reply brief, appellant asserts that respondent seeks to recover the proposed assessment amounts from the wrong taxpayer even though respondent acknowledges that PRSI remains liable as a surety. Appellant contends that respondent's reliance on California suretyship is misguided and irrelevant based on the facts presented; appellant maintains that the surety, PRSI, is not requesting that respondent first proceed against appellant as the principal obligor because PRSI has assumed the liability for the payment under the settlement agreement. (App. Reply Br., pp. 2-3.)

Appellant also repeats the following two arguments: (1) New PRSI is liable as a transferee as a result of the merger of Astra Oil into Astra LLC which immediately distributed virtually all of its tangible assets to New PRSI for no consideration; and (2) upon the merger, Astra Oil was treated for federal income tax purposes as having liquidated into its parent, PRSI, and PRSI succeeded to the assets, liabilities, and tax attributes of Astra Oil. Because California law conforms to the federal tax law treatment in this regard, appellant contends that PRSI should be treated by respondent as having succeeded to Astra Oil's tax liabilities. (App. Reply Br., pp. 4-5.)

Respondent's Contentions

Respondent contends that appellant does not contest the proposed deficiency assessments but rather asserts that respondent should be compelled to collect the payment from another party. For that reason, respondent contends that there is no controversy for this Board to decide and that the matter should be dismissed.

Respondent states that it commenced an examination of a group return filed by PRSI on behalf of appellant and, during the examination, PRSI notified respondent that it was terminating its role as the key corporation for appellant. Respondent asserts that PRSI's termination only affected its status as appellant's agent but PRSI remains a surety with respect to appellant's tax liabilities at issue. Respondent states that it issued NPAs to appellant rather than PRSI because PRSI had terminated its

status as appellant's agent. Respondent states that appellant filed a protest and then appealed respondent's NOAs so respondent may not mail a notice and demand until this appeal has been heard and decided by this Board. As long as this matter is outstanding, respondent states that it is unable to proceed with collection efforts against either party. (Resp. Op. Br., pp. 2-3.)

Respondent maintains that it is legally obligated to pursue appellant first for the collection of outstanding amounts due. Respondent cites California suretyship statutory provisions which provide that, while a surety guarantees the debt of another party, the other party is also legally obligated. Consequently, respondent asserts that, even though PRSI continues to act as the surety for appellant, appellant is primarily obligated for the additional assessments. Respondent further argues that, pursuant to Civil Code section 2845, the surety may require the creditor to proceed first against the principal obligor before pursuing the surety. Thus, respondent contends that appellant is also liable for the amount of the proposed deficiency assessments. (Resp. Op. Br., p. 3.)

In a reply brief, respondent states that it sent a collection letter dated November 30, 2012, to PRSI's current representative and the representative replied that PRSI is not legally or contractually responsible for the proposed assessments. Thus, contrary to appellant's contention that PRSI agreed to pay the tax amount, respondent asserts that PRSI categorically denies that it assumed any obligation. Respondent then argues that, regardless of whether PRSI is a surety for the proposed tax liability, respondent is legally obligated to pursue appellant first. Respondent also states that, once the liability is final and collectible, respondent will only collect the entire amount once. (Resp. Reply Br., pp. 3-4.)

Appellant's Additional Brief

Appellant filed an additional brief and attached a copy of a letter from PAI to respondent dated February 4, 2013, in which PAI concludes that "legally and contractually speaking [PAI] has nothing to do with the Assessment." Appellant asserts that Petrobras-Brazil and PAI deny their obligation to indemnify and hold harmless the Astra parties from the proposed deficiency assessments contrary to the provisions of the settlement agreement. Appellant quotes the second sentence of Section 5.10 of the settlement agreement which states, in relevant part, "Petrobras and PAI, jointly and severally, agree to indemnify and hold harmless the Astra Parties for any Tax (i) assessed or imposed

against PRSI and it subsidiaries for periods commencing before, on, or after September 1, 2006 . . .". Appellant contends that it and Astra LLC were subsidiaries of PRSI for periods commencing before September 1, 2006, and appellant was merged into Astra LLC on August 29, 2006, whereby PRSI owned all the outstanding membership interests in Astra LLC. (App. Add'l Br., pp. 2-3.)

Appellant further argues that the term "Tax" is defined as including the proposed deficiency assessments and the term "Astra Parties" includes appellant and Astra LLC. Appellant summarizes the reorganization transactions described in the prior briefing and concludes that PRSI succeeded to the assets and liabilities of appellant for California franchise tax purposes. Appellant then contends that respondent's interpretation of California suretyship law is "inappropriate and misguided" for the following reasons:

- Respondent acknowledges that PRSI remains liable as a guarantor or surety for appellant's tax liabilities which is consistent with the obligations of Petrobras-Brazil and PAI under the settlement agreement.
- As a matter of commercial practice, respondent may as a creditor pursue both the surety and primary obligor.
- The principal obligor is PRSI, not appellant or Astra LLC, as a result of the distribution of virtually all of the tangible assets to PRSI by Astra LLC. In that respect, PRSI stepped into the shoes of appellant as the "primary obligor".

Supplemental Briefing

The parties attended an appeals conference on August 29, 2013 and agreed to submit further briefing to address issues discussed at the conference. In a letter dated October 1, 2013, respondent addresses appellant's argument that, pursuant to federal tax law, "the effective liquidation of Astra Oil Company, Inc. into Astra Holding USA, Inc.", by means of appellant's merger into Astra LLC resulted in Astra Holding USA, Inc.'s assumption of appellant's tax liabilities. Respondent cites Treasury Regulation section 301.7701-2(c)(2)(iii)(A)(1) which provides that:

> For federal tax purposes, an entity that is disregarded as separate from its owner for any purpose under this section is treated as an entity separate from its owner for purposes of –
>
> Federal tax liabilities of the entity with respect to any taxable period for which the entity was

not disregarded; . . . .

Respondent concludes that this provision means that a disregarded entity is liable for the tax liabilities that existed before it became a disregarded entity. Respondent also quotes two examples of a domestic corporation that merges into a domestic LLC under a state law merger which apply the provisions of Treasury Regulation section 301.7701-2(c)(2) and concludes that these provisions illustrate the foregoing point. (Resp. Supp. Br., pp. 2-4.)

In response, appellant submitted a memo dated November 5, 2013, in which it takes issue with respondent's "argument that a certain exception in Treasury Regulation section 301.7701-2(c)(2)(iii), which treats single member domestic LLCs as a separate entity apart from its owner (rather than as a "disregarded" entity which generally is treated as part of its owner) undercuts [appellant's] position . . ." even though the relevant California regulation has not been amended to incorporate such an exception. Appellant argues that the exception is not relevant to the facts presented because it was intended to apply when a domestic corporation (Corp X) is merged into a domestic LLC (Z) that is wholly-owned by another domestic corporation (Corp Y) but the corporations did not file consolidated federal returns for periods prior to the merger. Appellant asserts that, if Corp X had been a member of Corp Y's consolidated group, then under Consolidated Return Regulation 1.1502-6(a), Corp X and Corp Y would be severally liable for each other's federal tax liabilities for such prior period and there would be no need for the IRS to resort to state law first to determine that Z was a successor to Corp X and therefore liable for the debts of Corp X under state law. (App. Supp. Br., pp. 1-2.)

Appellant explains that Astra Oil was a wholly-owned subsidiary of PRSI and joined in the filing of consolidated federal returns with PRSI for periods prior to the merger into Astra LLC. Appellant further states that, during that period, PRSI was the key corporation and surety of the payment of taxes by Astra Oil for those prior periods. By treating PRSI as a surety as a result of its key corporation designation, appellant asserts that California law is consistent with Consolidated Return Regulation 1.1502-6(a) in that PRSI is severally liable for the payment of taxes incurred by appellant for the period prior to the merger into Astra LLC. Appellant further asserts that respondent misses "the true 'merger' in this situation" which appellant again describes as appellant's merger into Astra LLC, the distribution of appellant's tangible assets for virtually no consideration and PRSI's distribution of

the Astra LLC's membership interests to AOT NV. (App. Supp. Br., p. 2.)

Appellant states again that the merger constituted a deemed complete liquidation of appellant into PRSI under IRC sections 332 and 337 whereby PRSI succeeded to the assets and liabilities and various tax attributes of appellant under IRC section 381. Appellant asserts that California has conformed to the IRC section 381 treatment and has not adopted the Treasury Regulation section 301.7701-2(c)(2)(iii) exception. Appellant further asserts that the merger was not only a deemed complete liquidation but a de facto liquidation of appellant into PRSI. Appellant concludes that, by focusing on the fact that under Delaware law Astra LLC is the successor to appellant "for an instant in time", respondent attempts to "saddle what was essentially a 'start-up' business conducted by a new taxpayer" with the tax liability of a business conducted by an old taxpayer for which PRSI should be held liable. (App. Supp. Br., pp. 2-3.)

Appellant contends that Examples 1 and 2 under the regulation are distinguishable from the facts presented because X and Y did not join in filing consolidated federal returns prior to the merger of X into Z and Z did not transfer virtually all of the tangible assets of X to Y. If X and Y had filed a consolidated group return then they would have been severally liable for each other's tax liabilities as described above, and the IRS would not need to determine whether Z as the successor to X was liable for X's tax liabilities under the applicable state merger law. Appellant further contends that Regulation 25106.5-11 is analogous to Consolidated Return Regulation section 1.1502-6(a) in that the key corporation is liable as a surety for the unpaid taxes of its subsidiary. Based on that authority, appellant concludes that respondent erroneously relies on California suretyship law in view of the fact that this matter involves the application of a California franchise tax regulation whereby the key corporation, PRSI, agreed in advance to pay the tax obligations of other group members "if such other members fail to do so." (App. Supp. Br., pp. 3-5.)

Applicable Law

Combined and Consolidated Reporting

Regulation 25106.5-11, subdivision (a) provides, in part, that taxpayers subject to the California Corporation Tax Law "that are members of a combined reporting group that includes another taxpayer that is also subject to the California Corporation Tax Law may annually elect to be included in

a 'group return'" . . . Subdivision (b) sets forth the eligibility requirements for electing group return filing status, including the definition of, and the requirements for the "key corporation" of the group. Subdivisions (d) and (e) describe the consequences of making an election and provides in relevant part that:

> (3) The key corporation is a surety for each taxpayer member for payments owed under the California Corporation Tax Law.
>
> (4) The key corporation is an agent for each taxpayer member.
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> . . .
>
> (6) All notices regarding the liability of a taxpayer member may be sent to the key corporation and additional amounts due with respect to any taxpayer member may be assessed and billed to the key corporation and it shall be liable for payment of such amounts.
>
> . . .
>
> (e) Duration of election to file group return. The election to file a group return for all matters for the taxable year of the election will remain in effect until 30 days following the receipt by the Franchise Tax Board of a written notice of termination of the election by any of the taxpayer members.

26 C.F.R. 1.1502-6(a) provides, in part, that "the common parent corporation and each subsidiary which was a member of the group during any part of the consolidated return year shall be severally liable for the tax for such year computed in accordance with the regulations under section 1502 prescribed on or before the due date (not including extensions of time) for the filing of the consolidated return for such year."

California Suretyship Law

California Civil Code section 2815 provides that "[a] continuing guaranty may be revoked at any time by the guarantor, in respect to future transactions, unless there is a continuing consideration as to such transactions which he does not renounce." In *Pearl v. General Motors Acceptance Corp.* (1993) 13 Cal.App.4th 1023, 1030, the Court of Appeal held that Civil Code section 2815 "essentially allows a guarantor to revoke his continuing guaranty at any time in order to preclude his liability for any future additional advance to the debtor. . . . Section 2815 allows a guarantor to effectively limit his potential losses by 'freezing' his liability for only those advances made up to the time of his revocation."

Business Entity Classification for Tax Purposes

Treasury Regulation section 301.7701-2(c)(2)(i) provides in relevant part that "[f]or

federal tax purposes -- [a] business entity that has a single owner and is not a corporation under paragraph (b) of this section is disregarded as an entity separate from its owner." Treasury Regulation section 301.7701-2(c)(2)(iii)(A) provides that "[a]n entity that is otherwise disregarded as separate from its owner is treated as an entity separate from its owner for purposes of: (1) federal tax liabilities of the entity with respect to any taxable period for which the entity was not disregarded." Treasury Regulation section 301.7701-2(c)(2)(iii)(B) sets forth the following examples to illustrate the application of paragraph (c)(2)(iii)(A):

> *Example 1.* In 2001, X, a domestic corporation that reports its taxes on a calendar year basis, merges into Z, a domestic LLC wholly owned by Y that is disregarded as an entity separate from Y, in a state law merger. X was not a member of a consolidated group at any time during its taxable year ending in December 2000. Under the applicable state law, Z is the successor to X and is liable for all of X's debts. In 2004, the Internal Revenue Service (IRS) seeks to extend the period of limitations on assessment for X's 2000 taxable year. Because Z is the successor to X and is liable for X's 2000 taxes that remain unpaid, Z is the proper party to sign the consent to extend the period of limitations.
> *Example 2.* The facts are the same as in *Example 1,* except that in 2002, the IRS determines that X miscalculated and underreported its income tax liability for 2000. Because Z is the successor to X and is liable for X's 2000 taxes that remain unpaid, the deficiency may be assessed against Z and, in the event that Z fails to pay the liability after notice and demand, a general tax lien will arise against all of Z's property and rights to property.

Transfer of Tax Attributes

IRC section 381 permits corporate taxpayers to preserve net operating losses and other tax attributes after an ownership change. Subdivision (a) of IRC section 381 provides that the tax attributes and other items specifically enumerated in subdivision (c) will survive the eligible reorganizations discussed. Among other items, subdivision (c) of IRC section 381 lists net operating loss carryovers, earnings and profits, capital loss carryovers, and tax credits under IRC sections 38 and 53.

STAFF COMMENTS

The parties agree that New PRSI is responsible as a surety for appellant's tax liabilities for the 2004 and 2005 tax years but differ over the legal effect of that suretyship status. Respondent argues that a surety under California law guarantees the debt of another party but the other party is primarily obligated and, thus, appellant is liable for the amount of the proposed deficiency assessments. Appellant contends that respondent misinterprets California suretyship law because New PRSI remains

liable as a surety for appellant's tax liabilities under the settlement agreement, a creditor may pursue both the surety and primary obligor as a matter of commercial practice, and the primary obligor here is New PRSI which stepped into appellant's shoes as a result of the distribution of virtually all of appellant's tangible assets. At the hearing, appellant should be prepared to explain its position that respondent erred by issuing the NPAs to appellant when, under California suretyship law, appellant is the primary obligor for its tax liabilities.

Respondent points to Treasury Regulation section 301.7701-2(c)(2)(iii)(A) and the examples as authority for its position that Astra LLC, as appellant's successor, is liable for the proposed additional tax assessed against appellant. Appellant argues that those examples are inapplicable here because under the facts presented in those examples, the entities were not members of a consolidated return group. Appellant argues that the applicable federal regulation is Treasury Regulation section 1.1502-6(a) which provides, in part, that the common parent corporation and each subsidiary that was a member of a consolidated return group is severally liable for the tax. At the hearing, the parties should be prepared to discuss whether the Treasury Regulation section 301.7701-2(c)(2)(iii)(A) can be harmonized with Treasury Regulation section 1.1502-6(a) such that Astra LLC is primarily liable for the proposed additional taxes at issue under the former regulation but New PRSI may be held secondarily liable if the tax debt against Astra LLC is uncollectible.

Appellant argues that there was a deemed liquidation of appellant into its parent corporation Astra USA as a result of appellant's merger into Astra LLC and, as a result, Astra USA is treated as having received and succeeded to all of Astra Oil's assets and liabilities and tax attributes under IRC section 381. At the hearing, appellant should be prepared to discuss in greater detail the tax effects under IRC section 381 and whether appellant takes the position that the 2004 and 2005 tax liabilities at issue are considered tax attributes under IRC section 381.

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