STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
STEPHEN H. McCORKLE, JENNIFER L. McCORKLE, AND PARTNERSHIP OF STEPHEN H. McCORKLE, ET AL	Account Number: SB S UT 084-115567 Case ID 486206
Petitioner	San Clemente, Orange County

Type of Transaction: Purchase of 50% interest in a vessel

Date of purchase: 03/29/05

Item	Disputed Amount
Purchase of 50% interest in vessel	$58,865

	Tax	Penalty
As determined:	$9,631.00	$963.10
Post-D&R adjustment	- 5,070.00	- 963.10
Proposed redetermination, protested	$4,561.00	$ 00.00
Proposed tax redetermination	$4,561.00	
Interest through 10/31/12	2,508.68	
Total tax, interest, and penalty	$7,069.68	
Monthly interest beginning 11/01/12	$ 22.80	

This matter was scheduled for Board hearing in March 2011, but was postponed at petitioner's request due to a scheduling conflict. It was rescheduled for Board hearing in June 2011, but was deferred at the request of the Appeals Division in order to issue an SD&R.

UNRESOLVED ISSUES

Issue 1: Whether petitioners' acquisition of an additional 50 percent interest in a vessel is subject to use tax. We find that it is.

Mr. McCorkle and Mr. Todd Mudd purchased the vessel in question as tenants in common. Mr. Mudd subsequently transferred his 50 percent interest in the vessel to petitioners, and petitioners now own 100 percent interest. Since Mr. Mudd does not hold a seller's permit for the sale of vessels, if any tax is owed on the transfer of the 50-percent interest, it is use tax for which petitioners are liable.

Mr. McCorkle and Mr. Mudd also owned a corporation together. Shortly after the vessel was purchased, Mr. Mudd chose to leave the corporation, and Mr. McCorkle and Mr. Mudd decided to also sever their co-ownership of the vessel (the corporation did not own any interest in the vessel and the vessel was not used for any business purpose). The parties effected the transfer of the ownership of the corporation and the ownership of the vessel in a single contract, but we regard the two transfers as separate. We thus do not consider the transfer of shares in the corporation as part of the consideration for transfer of the vessel. However, under the agreement, Mr. Mudd was released from any and all liability with respect to the vessel purchase (Mr. McCorkle agreed to refinance that debt so that Mr. Mudd could be released from his liability for the financing to make the original purchase of the vessel).

In accord with the agreement, on March 29, 2005, Mr. Mudd and Mr. McCorkle, as tenants in common, transferred title to the vessel to Stephen H. McCorkle and Jennifer L. McCorkle (petitioners) as joint tenants. Petitioners obtained new financing to pay off the prior financing obtained by Mr. Mudd and Mr. McCorkle. The Sales and Use Tax Department (Department) was notified by the U. S. Coast Guard of the transfer of the vessel's title, and it concluded the transfer was a purchase of the vessel by petitioners that was subject to use tax. Since petitioners failed to file the Consumer Use Tax Return it provided, the Department issued a Notice of Determination for tax of $9,631.00, which represented tax on 100 percent of the estimated purchase price of $124,271. After the appeals conference, petitioners provided a copy of the Buyer's Closing Statement, which established that the original purchase price of the vessel was $118,900. The Department recommended that the measure subject to use tax be reduced to $59,450, which is 50 percent of that original purchase price.

Petitioners contend that the transfer of the vessel from Mr. Mudd and Mr. McCorkle to petitioners did not constitute a purchase of the vessel. Notwithstanding that the parties signed an agreement requiring Mr. McCorkle to remove Mr. Mudd's name from the title of the vessel, to refinance the liability to release Mr. Mudd from liability, and to otherwise indemnify Mr. Mudd from further expenses related to the vessel, petitioners argue that no financial consideration was provided to Mr. Mudd, and thus there was no purchase of the vessel. Petitioners note that the agreement states there was not to be "any payment or reimbursement [to Mudd] for his share of the down payment of

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

the boat." According to petitioner, the purpose of the transfer was merely to take Mr. Mudd's name off the title to the vessel, and, since Mr. McCorkle's name was on the title to the vessel both before and after the transfer, no tax should be due.

Each transfer of title or possession of tangible personal property *for consideration* is subject to sales or use tax, unless an exemption applies. In addition to payments of cash, consideration also includes, among other things, an assumption of liability. Petitioners agreed to assume Mr. Mudd's liabilities associated with the vessel in exchange for Mr. Mudd's relinquishment of his rights in the vessel. Accordingly, we conclude that petitioners purchased Mr. Mudd's 50 percent interest in the vessel, and that the purchase is subject to use tax.

Despite the statement in the agreement that there was not to be "any payment or reimbursement [to Mudd] for his share of the down payment of the boat," petitioners stated in a June 28, 2010 letter that they have reimbursed Mr. Mudd for $8,204, which was his portion of the down payment on the original purchase of the vessel. We find that the consideration paid by petitioners to Mr. Mudd is the total of that amount and one-half of the amount that remained due on the loan at the time of the transfer to petitioners. Since petitioners have not provided evidence of the amount due on the loan at the time of the transfer, we have estimated that amount at $101,321.00, using an estimated average amount paid per day on the loan. Thus, we find that the consideration paid by petitioners to Mr. Mudd was $58,865 [$8,204 +$50,661 ($101,321 ÷ 2)].

Issue 2: Whether petitioners' use tax liability was discharged in their bankruptcy filing. We conclude it was not.

During the conference, petitioners stated that they filed a voluntary Chapter 7 personal bankruptcy petition on May 27, 2009, which listed the use tax liability owed to the Board as a debt. The bankruptcy court granted petitioners' discharge on November 24, 2009, and the case was closed on December 7, 2009. Petitioners were not sure whether the tax debt was discharged, but they understood that taxes are not generally dischargeable in bankruptcy.

As relevant herein, section 523, subdivision (a)(1)(B)(i) of the U. S. Bankruptcy Code states that a discharge under Chapter 7 does not discharge an individual debtor from a tax with respect to which a return was required but was not filed. Since petitioners were required to file a return to report

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

the use tax on their purchase of Mr. Mudd's 50 percent interest in the vessel but did not do so, petitioners' bankruptcy discharge did not discharge the use tax liability.

RESOLVED ISSUE

Since petitioners did not file a return, a failure-to-file penalty was applied. Petitioners have filed a request for relief of the failure-to-file penalty. We find that petitioners sincerely believed that they did not owe tax on the transfer to them of Mr. Mudd's 50 percent interest in the vessel and that there was no need to file a return. We find that the unique circumstances of this case, in which Mr. McCorkle was on the title of the vessel both before and after the transfer and had previously paid tax to the Board when he and Mr. Mudd originally purchased the vessel, could have easily resulted in confusion as to whether it was necessary to file a return to report the subsequent transfer of Mr. Mudd's interest in the vessel to petitioners. Therefore, we find petitioners' failure to file a return was due to reasonable cause, and we recommend that the failure-to-file penalty be relieved.

OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL