

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for)
 Reconsideration of Successor Liability)
 Under the Sales and Use Tax Law of:)
 GLEN EUGENE PEARSON III and) Account Number: SR KH 100-588810
 STEPHEN TERRANCE PEARSON ,) Case ID 406221
 dba Jewelry by Michael)
 Petitioner) Manteca, San Joaquin County

Type of Business: Jewelry retailer

Liability period: 04/01/00 – 06/30/05

<u>Item</u>	<u>Disputed Amount</u>
Successor liability	\$89,860

	<u>Tax</u>	<u>Penalty</u>
As determined:	\$83,365.37	\$17,149.37
Adjustment - Sales and Use Tax Department	- 9,147.22	- 3,202.56
- Appeals Division	<u>00.00</u>	<u>+ 2,233.88¹</u>
Proposed redetermination, protested	<u>\$74,218.15</u>	<u>\$16,180.69</u>
Proposed tax redetermination	\$ 74,218.15	
Interest through 4/30/11	56,544.01	
Penalty for failure to timely file return	35.10	
Finality penalties	4,719.15	
Negligence penalties	9,192.56	
Amnesty interest penalty	<u>2,233.88</u>	
Total tax, interest, and penalty	\$146,942.85	
Payments (by others)	- 538.85	
Balance Due	<u>\$146,404.00</u>	
Monthly interest beginning 5/1/11	<u>\$ 429.80</u>	

This matter was previously scheduled for Board hearing on February 23, 2011, but was postponed at petitioner's request to allow additional time to prepare for the Board hearing.

¹ An amnesty interest penalty of \$2,233.88 had been imposed on the predecessor at the time the assessment for successor liability was issued to petitioner, but had been inadvertently omitted from that successor liability. After the D&R was issued, the Department asserted the penalty (since this penalty is less than the amount of the penalty included in the successor liability that has been removed, the increase was not subject to Revenue and Taxation Code section 6563.)

UNRESOLVED ISSUES

1
2 **Issue 1:** Whether petitioner is liable as a successor for the unpaid liabilities incurred by Jewelry
3 by Michael Alan, Inc., and whether adjustments are warranted. We conclude petitioner is liable, and
4 no adjustments are warranted.

5 Petitioner's partners entered into a "Contract for Sale of Business" dated June 27, 2005, with
6 Michael Morales, the owner of Jewelry by Michael Alan, Inc. (SR KH 97-621021) for the purchase of
7 a retail jewelry business, which included inventory, fixtures and equipment, goodwill, a covenant not
8 to compete, and a leasehold interest, for a total selling price of \$185,000. The contract provides that
9 the seller had paid or would pay all taxes incurred by the seller during its operation of the business, and
10 that the seller would obtain a clearance from the Board concerning sales taxes. Petitioner began doing
11 business as Jewelry by Michael in July 1, 2005. In response to a request from the escrow agent,
12 Alliance Title Company (Alliance), the Sales and Use Tax Department (Department) issued a Notice
13 of Amounts due and Conditional Release informing Alliance, petitioner, and petitioner's partners that
14 Jewelry by Michael Alan had outstanding tax liabilities of \$185,000 that it had to pay before a tax
15 clearance could be issued. That notice also informed petitioner that it could be held responsible as a
16 successor for any liabilities that were not paid. On August 16, 2005, Alliance notified petitioner that
17 sufficient funds had not been deposited into the escrow account and that Alliance would resign as
18 escrow holder effective August 31, 2005. Nevertheless, petitioner continued to operate the business.
19 On August 31, 2005, Alliance notified the Board that it had resigned as escrow holder, that the escrow
20 had been cancelled, and that Alliance was refunding the amount held in escrow to petitioner. Also, on
21 August 31, 2005, petitioner closed its seller's permit and obtained a new seller's permit (SR KH 100-
22 629393), to operate as a three-person partnership, adding Michael Trey Pearson. That business
23 operated at the same business location, under the business name Glen & Sons Fine Jewelry.

24 At the time Jewelry by Michael Alan ceased its business operations, it had unpaid tax, interest,
25 and penalties totaling \$140,315.06 for the period April 1, 2000, through June 30, 2005, resulting from
26 three notices of determination, one sales and use tax return filed with partial remittance, and one return
27 filed with no remittance. The Department determined that petitioner had purchased a business or stock
28 of goods and, since petitioner had not obtained a receipt from the Board indicating that Jewelry by

1 Michael Alan's tax liabilities had been paid, or withheld from the purchase price an amount sufficient
2 to cover that business's outstanding tax liabilities, the Department concluded that petitioner was liable
3 as a successor.

4 Petitioner contends that it is not liable as a successor because the contract for sale of the
5 business was only a proposed contract that was never consummated. Petitioner asserts that, during the
6 period July 1, 2005, through August 31, 2005, it was in negotiations with Mr. Morales, and that the
7 contract referred to by the Department was simply petitioner's initial offer. Petitioner states that it
8 opened a seller's permit during the negotiations in order to operate the business for two months.
9 According to petitioner, however, it found the predecessor's representations regarding the business to
10 be false, and therefore the sale was never completed and the negotiations were cancelled. Petitioner
11 cites the failure of that purchase as the reason it closed its seller's permit and opened a new seller's
12 permit for a new business entity. Further, petitioner claims that no money was paid on the sale other
13 than the \$20,000 deposit it paid when it signed the proposed contract, and asserts that it tried to return
14 the inventory, fixtures, and equipment to Mr. Morales in exchange for the return of the \$20,000
15 deposit, but Mr. Morales would not make that exchange.

16 It is undisputed that petitioner did not receive a receipt from the Board showing that Jewelry by
17 Michael Alan did not owe any tax or a tax clearance. The evidence establishes that Jewelry by
18 Michael Alan transferred title and possession of the inventory, furniture, fixtures, and equipment of its
19 business to petitioner for consideration pursuant to contract of \$185,000, including payment in cash
20 and a promise to pay the remainder. We reject petitioner's argument that the contract was only a
21 proposed contract: not only is that assertion contrary to the specific language of the contract, but
22 petitioner also actually received the business inventory and fixtures and equipment from Jewelry by
23 Michael Alan. Petitioner also received various intangible assets, identified in the contract, and it took
24 advantage of the goodwill obtained from Jewelry by Michael Alan, since it operated the same business
25 in the same business location. Petitioner's assertion that the business was not worth the value claimed
26 by the seller is irrelevant since successor liability is based on the purchase price agreed to by the
27 parties, regardless of the reasonableness of that price. Thus, we find that, since petitioner purchased a
28 business and did not obtain a receipt or tax clearance from the Board showing no tax was due, it

1 became liable as a successor for the tax liabilities incurred by Jewelry by Michael Alan, up to a
2 maximum of \$185,000, the agreed-upon purchase price.

3 **Issue 2:** Whether the contract between petitioner and Mr. Morales was fraudulent and is
4 therefore void. We conclude the contract is not void.

5 In addition to its argument that the contract for sale of the business was only a proposed
6 contract that was never consummated, in a Request for Reconsideration (RFR), petitioner also asserts
7 that the contract between it and Mr. Morales is fraudulent because Mr. Morales had misrepresented
8 material facts, and that the contract is therefore void. As such, petitioner claims that the agreement is
9 vitiated and cannot be relied upon. On that basis, petitioner contends that the contract is void and the
10 successor liability cannot exceed the amounts actually paid to Mr. Morales, which petitioner states
11 totaled \$20,000. Petitioner also argues that Mr. Morales's failure to provide a tax clearance certificate
12 resulted in a failed condition of the contract, thereby extinguishing petitioner's duty to pay.

13 Revenue and Taxation Code section 6811 requires a successor to withhold sufficient of the
14 purchase price to cover the outstanding liability of the former owner until the former owner produces a
15 certificate stating that no amount is due. That withholding requirement attaches *at the time of sale*,
16 which in this case was June 27, 2005. With respect to petitioner's argument that the contract is
17 fraudulent, we first note that petitioner knew what it was signing, and it intended to enter into a
18 contract. Therefore, fraud in the execution of the contract did not exist. Petitioner asserts it was
19 misled into signing the contract by Mr. Morales's assurances that Jewelry by Michael Alan would pay
20 any outstanding tax liabilities. If that were true, petitioner might be able to show there had been fraud
21 in the inducement, which would present a case where the contract was voidable but would not support
22 a finding that the contract was void *ab initio*. When there is fraud in the inducement, the aggrieved
23 party may act to void the contract by rescission. However, for sales and use tax purposes, whether a
24 rescission occurred or not is irrelevant since the initial sale remains a sale under section 6006.
25 Successor liability attaches at the time of sale under section 6812 based on the purchaser's failure to
26 withhold the purchase price at that time, for the payment of the tax due, and once that liability is
27 incurred, it cannot be avoided based on a later rescission. In addition, we reject petitioner's argument
28 that Mr. Morales's failure to provide a tax clearance extinguished petitioner's duty to pay. Including a

1 requirement to produce a clearance certificate in a contract is advisable in order that the purchaser has
2 a right to not close the deal without bring in breach of the contract if the seller does not do so.
3 However, if the purchaser does not rely on that provision to terminate the contract, and instead chooses
4 to proceed with the transaction even in the absence of such a certificate, the inclusion of such a
5 provision does not act to absolve the purchaser from complying with the requirement to withhold an
6 amount from the purchase price sufficient to cover the predecessor's tax liabilities. For all these
7 reasons, we find no adjustment is warranted based on petitioner's claim that the contract is fraudulent
8 and therefore void.

9 **Issue 3:** Whether the Department issued the Notice of Successor Liability to the appropriate
10 party. We find that it did.

11 Petitioner contends that the Department incorrectly issued the Notice of Successor Liability to
12 it, asserting that the appropriate party was the three-person partnership that acquired the business after
13 August 31, 2005 (Glen Eugene Pearson III, Stephen Terrance Pearson, and Michael Trey Pearson).

14 Petitioner was the purchaser of the business, Jewelry by Michael Alan, and petitioner is the
15 purchaser who failed to comply with the requirements of section 6811. Accordingly, we find the
16 Department correctly issued the Notice of Successor Liability to petitioner.

17 **Issue 4:** Whether relief of the penalties included in the successor liability is warranted. We
18 find no basis to recommend relief.

19 The Notice of Successor Liability included several penalties. After various reductions to the
20 successor liability to reflect adjustments made to the predecessor's liabilities, the penalties total
21 \$16,180.69 (\$35.10 for late filing of a return, \$9,192.56 for negligence, \$4,719.15, of finality penalties,
22 and \$2,233.88 for an amnesty interest penalty). At the appeals conference, we explained to petitioner
23 that the penalties might be relieved for various reasons. We also explained that the absence of a
24 relationship between the successor and the predecessor is considered evidence of reasonable cause
25 sufficient to relieve the penalties in a successor liability. We informed petitioner that, in order for us to
26 consider relief, it would need to file a statement, signed under penalty of perjury, explaining its basis
27 for requesting relief, and we provided a form petitioner could use to do so. Petitioner has not returned
28

1 the form or otherwise requested relief. Thus, we have no basis upon which to consider recommending
2 relief of the penalties included in the successor liability.

3 **OTHER DEVELOPMENTS**

4 None.

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