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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 scheduled by Senior Staff Counsel James E. Mahler for April 17, 1991, in San Jose, California.

Appearing for Petitioner:

Appearing for the Sales and Use Tax Department:

Fred Berkey
Supervising Tax Auditor

Julia Hood
Tax Auditor

Protested Item

The protested tax liability for the period July 1, 1985, through June 30, 1988, is measured by:

<u>Item</u>	<u>State, Local, County, SCCT & SCTA</u>
C. Intercompany transfer of fixed assets	\$322,148

Petitioner's Contentions

1. The assets in question were neither sold to nor purchased by petitioner.

2. If the assets were sold and purchased, the transactions qualify as exempt occasional sales.

3. If the transactions were taxable, the tax is due from the seller, not from petitioner.

4. If the tax is due from petitioner, the audit measure of tax is excessive.

Summary

Petitioner was a corporation which manufactured and sold medical equipment at a facility in Mountain View, California. It was a wholly owned subsidiary of [redacted] during the periods involved herein. We understand that petitioner was later liquidated or merged into [redacted] as of December 31, 1988.

[redacted] is also engaged in the business of manufacturing and selling medical devices. It did business during the periods in question through various divisions or "units". One unit was located in Houston, Texas; another was located in Salt Lake City, Utah, and operated under the name [redacted]; and a third did business under the name [redacted] in Mountain View, California, in the same facility used by petitioner.

In the fourth quarter of 1987 and the first quarter of 1988, various assets were transferred from the [redacted] unit to the facility in Mountain View. The transferred assets included computers, printers, a plotter, microscopes, mills, a grinder, a lathe, "Bezel" tools, pump cases and other miscellaneous equipment.

In the second quarter of 1988, other assets were transferred from [redacted] Houston unit to the Mountain View facility. These assets are identified only as "fixed assets" and are not otherwise described in the record before us.

All these assets were recorded in petitioner's fixed asset accounts at net book value (initial cost to [redacted] minus accumulated depreciation) as of the transfer dates. According to the audit staff, petitioner admitted to the auditor that its books also showed "intercompany" accounts payable to [redacted] as a result of these transfers.

Petitioner's representative at the Appeals Conference stated that petitioner's books had shown "intracompany" liabilities to Abbott, but argued that no

money had ever changed hands because the liabilities were "consolidated" when petitioner was merged into . The audit supervisor speculated that the liabilities were probably "written off" as part of the merger. He also alleged that petitioner had claimed depreciation deductions on the assets for periods after the transfers and prior to the merger.

We requested additional briefing to clarify the accounting treatment of these assets. Petitioner's representative responded by letter dated July 1, 1991, stating that the assets "were transacted in the respective accounting ledgers of each location through our intracompany transfer accounts"; that such accounts are "used by the entire corporation as a clearing account to ensure reconciliation and communication of the valuation of accounting transactions...within the corporation"; and that it was an "error...to place the debt entry onto" petitioner's books.

Analysis and Conclusions

1. Petitioner has consistently referred to the asset acquisitions as "intracompany" transactions. Petitioner concedes however, that it and were in fact separate corporations. If the transfers were "sales" and "purchases", therefore, tax applies to the same extent as to transactions between unrelated entities. (See Mercedes-Benz v. State Bd. of Equalization, 127 Cal.App.3d 871.)

The terms "sale" and "purchase" are defined in Revenue and Taxation Code Sections 6006 and 6010, respectively, to include transfers of title or possession of tangible personal property for a consideration. Petitioner contends that the asset transfers were neither sales nor purchases on three distinct grounds: (a) possession was not transferred to petitioner; (b) title was not transferred to petitioner; and (c) no consideration was paid.

(a) The assets in question were admittedly delivered to the Mountain View facility for use there. The Mountain View facility was occupied, not only by petitioner, but also by Unit. Petitioner alleges that the exclusive possession of the assets and used them to service medical devices sold by . The assets were supposed to have been recorded in the Unit's books, but were recorded in petitioner's books by error.

In effect, petitioner is attempting to impeach its own business records. The assets were all booked as capital assets in petitioner's accounts, and this is evidence that petitioner had possession and use of them. Petitioner has submitted no evidence to support the allegation that the Unit had exclusive possession. The assets (computer equipment, lathes, etc.) were all of a type which could have been used by petitioner in its manufacturing operations.

The accounting treatment of these assets is prima facie evidence that petitioner had possession. If contrary evidence is available, petitioner may present it in a Request for Reconsideration as explained in the cover letter attached to this Decision and Recommendation. (Such evidence might consist of requisitions showing that the assets were assigned to personnel employed by the Critical Care Unit, not to personnel employed by petitioner; site layouts showing that the assets were installed in an area of the facility used exclusively by the Critical Care Unit; or similar accounting records.) On the basis of the record before us at this time, however, we find that petitioner had possession and use of the assets.

(b) Petitioner next alleges that it never acquired title in the assets. Petitioner has submitted a letter from [redacted] division counsel stating that "there were no documents prepared...to transfer legal title to the equipment...."

This letter is essentially meaningless. Title can certainly be transferred without documents of title (see California Commercial Code Section 2401); the absence of title documents is therefore inconsequential.

As above, petitioner has failed to persuade us that its business records were incorrect. The fact that petitioner recorded these assets in its books of account is evidence that petitioner had both title and possession. (If petitioner also claimed depreciation deductions on these assets, as the staff contended at the hearing, this would be even stronger evidence that petitioner had title.) Lacking any contrary evidence, we find that petitioner did acquire title to these assets.

(c) Petitioner alleges that no cash changed hands in connection with the transfers of assets. From this, petitioner concludes that there was no consideration for the transfers. Petitioner cites Macrodyne Industries, Inc.

v. State Bd. of Equalization, 192 Cal.App.3d 579. We disagree.

The audit found, and petitioner appears to concede, that its books reflected liabilities owing to as a result of these transfers. Petitioner thus recognized an obligation to pay [redacted] for the assets. Whether the obligation was ultimately satisfied by payment of cash, transfer of goods, offset against payables, or in some other fashion, is simply irrelevant. Petitioner's promise to pay [redacted] for the assets constituted consideration, even if the debt was never paid.

The Macrodyne case is factually distinguishable. In that case, property encumbered by liabilities was transferred and the transferee promised to pay the liabilities. Since the transferor remained primarily liable, however, the court found no consideration. (But see Cal-Metal Corp. v. State Bd. of Equalization, 161 Cal.App.3d 759.) The consideration in this case is petitioner's promise to pay [redacted] for the assets, not a promise to pay off pre-existing liabilities.

2. Revenue and Taxation Code Section 6367 authorizes an exemption for certain "occasional sales". That term is defined in Section 6006.5(a) of the Code to mean a sale of property not held or used in the course of activities requiring a seller's permit, or which would require a seller's permit if conducted in California. Petitioner alleges that [redacted] held or used the assets in question in a service business which did not require a seller's permit.

It is undisputed that [redacted] was engaged in the business of manufacturing and selling tangible personal property. This business required a seller's permit, or would require a permit to the extent conducted in California. There is no evidence to show that [redacted] was engaged in any service business at all, let alone evidence to show that the assets in question were held or used in such a service business. The sales to petitioner therefore do not qualify as exempt occasional sales.

It should also be noted that the assets in question were sold to petitioner in a series of three separate sales. This series was itself an activity requiring a seller's permit, and the sales would therefore not qualify for the exemption even if the assets had otherwise been held or used exclusively in a service

enterprise. (Chemed Corp. v. State Bd. of Equalization, 192 Cal.App.3d 967.)

3. Petitioner next contends that the applicable tax on these transactions was a sales tax on _____, not a use tax on petitioner.

When property is shipped or brought into California from a point outside this state, sales tax does not apply unless: (1) the sale occurs in California; and (2) there is participation in the transaction by a California office or other local place of business of the seller. (Sales and Use Tax Reg. 1620(a)(2).) The sale occurs in California when title passes to the customer in this state. (See Rev. & Tax. Code § 6010.5.) Unless the parties have otherwise agreed, if the seller is required or authorized to send the goods to the buyer but not required to deliver at destination, title passes to the buyer at the time and place of shipment. (Cal. UCC § Section 2401(a).)

There is no evidence in this case to suggest that title passed in California rather than at the out-of-state shipping point. Nor is there any evidence of local participation in the transaction by an office or other place of business of _____. Since petitioner has failed to prove that _____ was liable for sales tax, petitioner is liable for use tax. (Rev. & Tax. Code § 6401.)

4. The audit assessed use tax measured by the net book value of the assets as recorded in petitioner's books. Petitioner contends that the tax should have been measured by the fair market value of the assets, which was allegedly lower than net book value.

Revenue and Taxation Code Section 6201 imposes use tax measured by the "sales price" of the property. The term "sales price" is defined in Section 6011 of the Code to mean the total amount for which the property is sold. If the true sales price is not known, the book value or fair market value of the property might be helpful in determining what the price was, but such values are otherwise irrelevant.

In this case, the sales prices were the amounts which petitioner recorded on its books as liabilities owing to _____ as a result of the asset transfers. In the normal course of events, the recorded liabilities would have been equal to the net book values of the assets, and we therefore conclude that the audit measure of tax is correct. If petitioner believes that the recorded

liabilities were in fact lower than the net book values, it should present supporting evidence in a Request for Reconsideration.

Recommendation

Redetermine without adjustment to the tax.

James E. Mahler
James E. Mahler, Senior Staff Counsel
2/11-22-91

11/22/91
Date