

4. To impose a tax would tax petitioner twice since it paid tax on its original purchase of the assets.
5. Petitioner could have made the transfer in a manner which would not have resulted in any sales tax liability.
6. Petitioner should not be taxed because it relied upon incorrect and incomplete Board advice.

Summary

Petitioner operated as a new vehicle dealer with vehicle sales, leases, repairs, parts sales, and towing services. In 1991, it ceased the towing services as a result of a corporate reorganization. A prior audit covered a period which ended on December 31, 1988.

The Department established a sales tax liability for the second quarter of 1991 measured by \$107,914 on the basis that petitioner had made taxable retail sales of several non-inventory tow trucks to _____, on January 1, 1991 without the payment of sales tax. The Department represented that _____ had assumed \$275,964.67 of petitioner's liabilities and provided first issue shares of _____ stock to petitioner as part of an exchange of \$200 cash, \$846.77 in prepaid expenses, \$59,327.72 accounts receivable, and tow trucks which were then valued at \$247,609. These liabilities consisted of \$137,453.96 in notes payable related to the tow trucks, \$125,772 in depreciation, and \$12,738.71 in accrued commissions. The Department obtained a _____ record which showed those entries as part of its initial capitalization as of January 1, 1991. The \$107,914 measure was calculated from an Audit Manual formula to allocate the total liabilities to the tow trucks portion of the assets transferred in accordance with Sales and Use Tax Regulation 1595(b)(4).

The Department's representative explained that the Department had considered the occasional sale exemption as defined in Revenue and Taxation Code section 6006.5(b), but found it inapplicable since petitioner had transferred less than 80 percent of all of its assets. Petitioner was treated as having conducted one activity at one location. The Department did not separate the towing services from petitioner's other functions because vehicles were sometimes towed to petitioner for repair work. The Department also considered the exemption in Regulation 1595(b)(4), but found it not applicable on the basis that _____ had assumed petitioner's liabilities.

The audit workpapers indicate that the Department had made an error in issuing BT-111s to petitioner to allow a change in DMV registration (schedule 12). That schedule refers to a January 23, 1992 Board form BT-106 entitled "Vehicle/Vessel Use Tax Information" which was signed by a Board employee, and by [REDACTED] on behalf of [REDACTED]. That document constitutes a claim by [REDACTED] for a use tax exemption on the December 30, 1991 transfer of one of these tow trucks on the basis of being a transfer to a commencing corporation which the Department concluded was exempt. A certificate of exemption was indicated as having been issued.

Petitioner's representatives provided the following information at the conference:

Petitioner's shareholders during the audit period were [REDACTED]. On or about January 1, 1991, [REDACTED] was incorporated. Petitioner became the sole shareholder on January 1, 1991 when it acquired 32,000 shares of [REDACTED] stock.

The tow trucks were tax-paid assets since petitioner had paid tax at the time of its original purchase. Entries were made in petitioner's books to remove the assets and liabilities. [REDACTED] made entries in its books for the assets and liabilities acquired by it. The effective date of the entries was January 1, 1991 although the entries were not actually made until December 1991 following accounting work at the end of the fiscal year in mid-September 1991. The notes payable had been due from petitioner to [REDACTED]. Starting in February 1991, [REDACTED] paid the notes from funds which came from [REDACTED] bank accounts which were opened in February 1991 when it first began operations. Petitioner still remained liable to [REDACTED] on the notes after the transfer.

The title documents evidencing the transfers of the trucks were dated December 31, 1991 and were filed with the DMV in January 1992. The Board employee who prepared the above-mentioned BT-106 form then also issued various certificates of tax clearance for excise tax and use tax. The excise tax certificates were issued to petitioner. The use tax certificates have not been submitted to me. [REDACTED] took those records to DMV in January 1992. DMV registered and licensed the trucks to [REDACTED] without requiring any use tax payments.

The towing operations had been conducted at [REDACTED] Chico, separate from the dealership operations at [REDACTED] Chico. Petitioner had maintained a dispatch office and a vehicle storage yard for the towing operations on [REDACTED]. Seven employees had been employed by petitioner solely

[REDACTED]

for towing duties. Five truck drivers, including one supervisor, had driven the trucks from that [REDACTED] location.

Petitioner had used multiple fictitious business names, including [REDACTED] "Towing" for the towing operations. The mail was delivered only to [REDACTED]. Some bookkeeping for the towing operations was handled initially by employees at [REDACTED] but petitioner's staff at [REDACTED] later performed most of those and related functions. Separate account numbers were maintained in petitioner's books for the towing income and expenses. One federal income tax return was filed for each year to report income for all operations. The seven towing employees had obtained their paychecks at the [REDACTED] location.

[REDACTED] represented that 85 to 90 percent of petitioner's towing was for [REDACTED] members under a contract between [REDACTED] (personally) and [REDACTED]. Some vehicles were towed to petitioner's [REDACTED] location for petitioner's repair work, whether under an [REDACTED] tow or otherwise. In order for a person to obtain a tow, a call had to be placed to petitioner's dispatcher at the [REDACTED] location on a separate telephone number used only for petitioner's towing operations. This applied even to petitioner's employees such as [REDACTED] and to [REDACTED] who once tried unsuccessfully to get a tow by calling the dealership telephone number, even though he had been [REDACTED] friend and accountant for over 20 years. No employee at the dealership had the authority to dispatch a tow truck. As part of his duties, the supervising tow truck driver had reported to [REDACTED] and a manager at the dealership location.

In December 1991, [REDACTED] was concerned about this situation from a sales tax standpoint. She explained that she then knew based upon the accountant's advice that no sales tax applied to the transfer because petitioner and [REDACTED] had the same ownership. She ordered [REDACTED], petitioner's vehicle clerk, to contact the Board and DMV to get documents to change ownership in the trucks which would verify that no sales tax applied. [REDACTED] made the call, and informed [REDACTED] that tax clearances were needed. [REDACTED] ordered [REDACTED] to obtain tax clearances. [REDACTED] obtained records from the Board, took them to DMV, and caused the transfer of title in the trucks without the payment of any taxes.

[REDACTED] represented that there was no assumption of liabilities by [REDACTED] but merely a taking subject to existing liabilities. However, he provided me with a copy of an "Action of Board of Directors of [REDACTED] Without First Meeting" dated January 1, 1991. Among many other

contents, that document provides as follows:

1. [redacted] accepted petitioner's offer to transfer these assets in exchange for [redacted] assumption of these liabilities and 32,000 shares of [redacted] common stock. Five loans from [redacted] to petitioner were identified on an exhibit as "being assumed by" [redacted].
2. Upon receipt of such consideration, [redacted] would issue to petitioner the 32,000 shares.

In a document entitled "Minutes of Special Meeting of Board of Directors of [redacted] Inc.", dated December 30, 1991, it is provided that the transfer from petitioner to [redacted] of "certain" vehicles required by [redacted] as part of its daily towing operation, plus "any related obligations", and that the transfer be "free of any consideration". It was also indicated that "no consideration was to be made for this transfer due to the fact that both corporations share the exact same ownership."

The stated reasons for the switch of the towing services and trucks included the tax planning for the [redacted] family, and to fix the existing accounting problem in dealing with the towing operations.

Analysis and Conclusions

Is petitioner liable for sales tax?

Absent an exemption, sales tax is imposed upon retailers measured by the gross receipts which they derive from California retail sales of tangible personal property (Revenue and Taxation Code § 6051). "Sale" is defined as the transfer of title or possession of that property for consideration (Rev. & Tax. Code § 6006(a)). A DMV-licensed vehicle dealer is a type of retailer who can be liable for sales tax on the retail sale of a vehicle (see Rev. & Tax. Code § 6283).

There is valuable consideration sufficient to constitute a taxable retail sale of non-inventory assets when a parent corporation transfers all of the property (and associated liabilities) held or used by one of its divisions to a commencing wholly-owned subsidiary corporation in exchange for first issue shares of stock in the subsidiary plus the subsidiary's assumption of such liabilities (Beatrice Company v. State Board of Equalization (1993) 13 Cal.4th 69).

We thus conclude in this case that there was valuable consideration sufficient to constitute a "sale". The January 1, 1991 documentation shows there was an assumption of liabilities by [redacted] Petitioner's offer to transfer the trucks included a term of [redacted] assumption. [redacted] accepted that offer. Following the transfer, petitioner removed the liabilities from its books, and [redacted] entered the liabilities on its books as its own liabilities. From its own funds, [redacted] thereafter paid Chrysler on the notes. An assumption of obligations can be found to have occurred even without an express assumption agreement in situations involving the assignment of rights under an executory contract when the assignor and assignee so intend; and such intent can be ascertained by their actions (Enterprise Leasing Corp. v. Shugart Corp. (1991) 231 Cal.App.3d 737, 745-746). The available evidence here shows the intent of petitioner and [redacted] to have [redacted] assume petitioner's liabilities, and their subsequent actions in that manner. The December 30, 1991 [redacted] directors' minutes which reference a lack of consideration is not accepted as indicative of the situation. That was based upon a mistake of law which led them to believe that no consideration existed because of the same ownership in petitioner and [redacted]. Further, as discussed, infra, the sales had already occurred by December 30, 1991.

The fact that petitioner remained liable to [redacted] did not prevent consideration from arising since [redacted] suffered a detriment on its assumption (Beatrice, supra), and on its subsequent payments to [redacted] (see Civil Code § 1605). Beatrice rejected that taxpayer's contention that no consideration arose because of the transferor's continued liability to the creditor. Also, the value of the shares is irrelevant since there was an assumption.

Although Regulation 1595(b)(4) is not applicable since the property in question involves vehicles (see discussion, infra), the Beatrice opinion discussed that provision as part of the consideration issue and found it inapplicable to exempt that taxpayer because there had been an assumption of liabilities by the transferee in addition to the transfer of property to a commencing corporation in exchange for first issue stock.

Revenue and Taxation Code section 6006.5 is not applicable. It is an "occasional sales" provision for which Revenue and Taxation Code section 6367 provides for an exemption if various requirements are met. However, section 6367 expressly reads that such exemption does not apply to gross receipts from sales of vehicles. But Revenue and Taxation Code section 6281 effectively provides for an exemption similar to section 6367 as defined in section 6006.5(b). Revenue and Taxation Code section

6281 provides for an exemption from sales tax for the gross receipts from the sale of a vehicle when: (1) the vehicle is included in a transfer of at least substantially all the property held or used in "the course of business activities" of the transferor; and (2) the real or ultimate ownership of the vehicle is substantially similar after the sale (see also Regs. 1610(b)(2)(C), and 1595(c)).

Sales tax exemptions are strictly construed against the taxpayer, and it has the burden to prove the applicability of the exemption (Standard Oil Co. v. State Board of Equalization (1974) 39 Cal.App.3d 765).

Although there were various factual separations in petitioner's operations prior to the reorganization, we conclude that petitioner conducted one business activity rather than two. Thus, petitioner did not transfer to at least substantially all the property held or used in the course of its business activities, and section 6281 does not apply.

Petitioner was one person, a corporation, prior to the exchange. All the people who worked at the dealership and at the towing office/storage yard were employees of petitioner. All of the work involved vehicles. Part of the reason for the towing operations concerned the dual purpose of generating towing income as well as dealership income. When the trucks towed vehicles to the dealership, petitioner was also typically able to generate income from maintenance (body shop, parts, etc.) work and sales. That was a distinct connection between the towing and dealership operations.

The Beatrice opinion also rejected that taxpayer's argument that no taxable sale had occurred because a corporate reorganization had taken place. In the absence of any other provision in the Sales and Use Tax Law to exempt sales made in corporate reorganizations, petitioner also is not exempt from sales tax on the gross receipts derived from these sales of tow trucks which occurred as part of a corporate reorganization.

There is no double taxation or reason not to impose this sales tax against petitioner solely because it paid either use tax or sales tax reimbursement when it originally purchased these tow trucks. It is each sale and purchase which causes the imposition of a sales or use tax, respectively (Rev. & Tax. Code §§ 6051, 6201, and 6202). When petitioner purchased each of these trucks, that was either a "sale" which created sales tax liability on the seller with petitioner paying sales tax reimbursement, or a "purchase" which created use tax liability against petitioner if no sales tax could be imposed on the seller

(see Reg. 1610(b), and (c)(1)). The sales tax on petitioner now is a result of its sales to C & S.

Whether or not petitioner could have transferred these tow trucks to _____ in a manner which could have resulted in no sales tax liability is irrelevant. Sales tax is imposed upon a person based upon the substance of what occurred, not upon something else which could have taken place but did not happen (Simplicity Pattern Co. v. State Board of Equalization (1980) 27 Cal.3d 900, 915).

It is our conclusion that petitioner should not be relieved of its sales tax or interest liabilities due to the December 1991 and January 1992 communications between petitioner or _____ and the Board or DMV. Petitioner and/or _____ made multiple mistakes which led to incorrect and/or incomplete information being supplied to the Board. _____ acted upon the directions of _____ who incorrectly thought that there was no sales tax on petitioner's transfer to _____ merely because there was a similar ownership in petitioner and _____. Further, those actions of the Board and DMV appear to have concerned excise tax and use tax. Use tax was not applicable to _____ because sales tax applied to petitioner which was a DMV-licensed vehicle dealer (Reg. 1610(b)(1)(A)). More importantly, the sale of each vehicle had already occurred back in January or February 1991 when the parties, in substance, effectively transferred possession and beneficial/equitable title/ownership in the vehicles in exchange for _____ promise to assume the liabilities. That was a "sale" as to each vehicle (Rev. & Tax. Code § 6006(a) and (e)). In February 1991, _____ began business with possession and control of the trucks, and even began making payments on the liabilities it had assumed. The retention of bare legal title until December 1991 did not delay the sales which the parties intended and substantively consummated in the first quarter of 1991. Thus, the actions of the Board and DMV in December 1991 and January 1992 are irrelevant to petitioner's sales tax liability.

Recommendation

Redetermine without adjustment.

Stephen A. Ryan

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2-8-94

Date