STATE OF CALIFORNIA

535.0022

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition	)	
for Reconsideration of		)
Successor's Liability Under the	)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:	)	
	)	
F--- W--- P---, INC.	)	No. SR -- XX-XXXXXX-010
	)	
	)	
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Paul O. Smith, Staff Counsel on July 12, 1994, at Van Nuys, California.

Appearing for Petitioner: Appearance Waived

Appearing for the
Sales and Use Tax Department: Ira C. Anderson, CPA
Supervising Tax Auditor

Protested Item

The protested tax liability for the period April 1, 1992 through June 30, 1992, is measured by:

Item	Amount
Successor's tax liability.	$19,092.30

Petitioner's Contentions

Petitioner contends that it did not purchase the seller's business; it acquired the business by foreclosure, and therefore no successor liability should result.

Summary

On or about July 1, 1992, petitioner F--- W--- P---, Inc., as buyer, and T--- I---, Inc. (hereinafter "T---"), as seller, contracted for the sale of T---'s business. The assets sold were "any and all contracts and agreements for [T---'s] services; and ... equipment, including leasehold interests in equipment...." The sales price was $50,000.[1] The sales price was secured by a security interest in any and all furniture, fixtures, equipment, stock-in trade, contracts, accounts and commercial paper of the service business of petitioner and T---, and the assets sold pursuant to the contract. (See Exhibit A). Concurrent with the execution of the contract of sale, petitioner issued a notarized Promissory Note to the order of T---. The note required that unpaid principal and interest was payable at $1,000 per month, beginning August 1, 1992. (See Exhibit B).

At all relevant times before July 1, 1992, petitioner was a creditor of T---, and had a security interest in T---'s assets. On or about July 1, 1992, T--- defaulted on its obligations to petitioner. Petitioner states that because of the default it exercised its rights as a secured creditor and foreclosed on T---'s assets.

On April 14, 1993, the Sales and Use Tax Department (Department) issued a Notice of Successor's Liability for tax owed by T--- under account number AC XX-XXXXXX. On April 30, 1993, petitioner filed a timely Petition for Reconsideration.

Analysis and Conclusions

Revenue and Taxation Section 6811 provides that when any person liable for the sales or use tax sells his business or stock of goods or quits the business, his successors or assigns shall withhold a sufficient amount of the purchase price to cover the amount of tax owed until the former owner produces a receipt from the Board showing that it paid the or a certificate showing that no amount of tax is due. Section 6812 provides that if the purchaser fails to withhold from the purchase price the amount required by Section 6811, he or she becomes personally liable for payment of the amount required to be withheld by him or her to the extent of the purchase price, valued in money. (See also Cal. Code Regs., tit. 18, reg. 1702.) Sections 6811 and 6812 were enacted to prevent a seller who failed to pay the state all the taxes due from both the operation and the sale of his or her business from departing with the full purchase price. (See Knudsen Dairy Products, Co. v. State Bd. of Equalization (1970) 12 Cal.App.3d 47, 52.)

---

1 The contract provides that the purchase price shall be paid to T--- in a combination of cash and materials and supplies. The payment, however, was calculated by adding the cash contributions and liabilities owed by T--- to petitioner, and its shareholders and affiliated companies, in excess of petitioner's $50,000 investment in T---. (Exhibit A, p.1, § 2)

Here, petitioner does not dispute that it is the successor to the business of T---; petitioner argues that it acquired the property by foreclosure, and a foreclosure is not a sale within the provisions of section 6811, et seq.

I agree with petitioner that a foreclosure is not a sale for purposes of sections 6811 and 6812. In order for successor's liability to be asserted there must be a sale of the business or stock of goods for successor's liability to attach. However, I do no not agree that here a foreclosure occurred.

The term foreclosure is a term of art. The enforcement of liens by courts of equitable jurisdiction is ordinarily termed foreclosure; it is the method of enforcing the payment of debts out of property subject to a lien. (Willen v. Willen (1932) 121 Cal.App. 351.) In a foreclosure there must be some form of unilateral action by the creditor. (Page v. W.W. Chase Co. (1904) 145 Cal. 578.) Here, the only evidence of the property transfer from T--- to petitioner is a "contract of sale" of the business of T---, and a promissory note for payment of the sales proceeds. It is well settled that taxpayers are generally free to structure their affairs as they please even when motivated by tax reduction considerations. (Gregory v. Helvering (1935) 293 U.S. 465.) Petitioner and T--- could have structured the transaction as a foreclosure, but they didn't.

They structured the transaction as a sale of the business of T---. Where, as here, there is a genuine transaction with economic substance, and it is not shaped by tax avoidance or another noneconomic reality, the structure of the transaction should be honored. (See Frank Lyon Co. v. U.S. (1978) 435 U.S. 56 [55 L.Ed.2d 550].) Petitioner is therefore bound by the form of the transaction. Thus, the Department properly imposed upon petitioner the statutory liability created by sections 6811 and 6812.

Recommendation

Deny the petition.

_____ _____
Paul O. Smith, Staff Counsel Date

Exhibits A & B