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:	
SOUTHCORP PACKAGING USA, INC.	Account Number: SR EH 30-686900 Case ID 224867
Petitioner	Napa, Napa County

Type of Business: Sales of molded plastic containers

Audit period: 01/01/99 – 06/30/01

Item	Disputed Amount
Unreported sale of assets	$6,746,835

Tax as determined:	$530,729.00
Less concurred	44,421.22
Balance, protested	$486,307.78
Proposed tax redetermination	$530,729.00
Interest through 6/30/06 (tax paid in full on 6/22/06)	224,053.97
Total tax and interest	$754,782.97
Payments	754,782.97
Balance Due	$ 00.00

This matter was previously scheduled for Board hearing on March 9, 2005, but was postponed for settlement consideration. The hearing was rescheduled for March 7, 2006, but the matter was deferred because petitioner submitted a request for reconsideration (RFR). After issuance of a Supplemental Decision and Recommendation, the hearing was scheduled for November 12, 2008, but was postponed at petitioner's request to allow additional time to prepare for the hearing and file a brief.

UNRESOLVED ISSUES

Issue 1: Whether petitioner made a taxable retail sale of its non-inventory tangible personal property business (capital) assets. We conclude that its sale of capital assets was subject to tax.

Petitioner was in the business of manufacturing and selling rigid plastic packaging products. Petitioner and certain of its affiliates entered into an Asset Purchase Agreement (APA) with North American Packaging Corporation (NAMPAC), in which it agreed to sell substantially all of its assets (other than real estate), including those involving its Ontario plant, to NAMPAC. The parties executed the APA on June 29, 2001, which was the actual effective date of the agreement, but it was dated "as of" February 28, 2001. Petitioner paid no sales tax on the sale of capital assets at the Ontario plant. The Sales and Use Tax Department (Department) concluded that sale of assets was subject to tax and included the selling price in the understated measure established by audit.

Petitioner originally contended that it had no tax liability with respect to the transfer of the capital assets at issue because it transferred the assets to NAMPAC in two separate transactions, neither of which were subject to sales tax. Petitioner asserted that, on February 15, 2001, it formed SC Plastics, LLC (SC Plastics), with petitioner as its only member or shareholder. Petitioner further asserts that on February 28, 2001, it transferred all of its assets associated with the Ontario plant to SC Plastics, solely for a membership interest, and thereafter, on June 29, 2001, made the sale pursuant to the APA which included the sale of the membership interest in SC Plastics.

The Department recognized that each of these transactions, if they had occurred as alleged and if viewed in isolation, would have been non-taxable. However, the Department concluded that each of these transactions were steps in a single taxable transaction. In the D&R, we found that the step transaction doctrine should be applied, and the steps should be viewed as elements of a single transaction, which was a taxable sale of capital assets by petitioner to NAMPAC.

Petitioner filed an RFR dated November 1, 2005, asserting that the step transaction doctrine should not cause two non-sale transactions to be collapsed into one taxable sale because genuine independent business reasons supported each separate transaction. Petitioner asserts that there were two fully separate transfers concerning the Ontario plant, but bases that assertion on facts that are different from those described by its prior representatives and addressed in the D&R. Petitioner contends that an understanding of the substance of what actually occurred indicates that there were actually two separate transactions, and there were genuine business reasons for the separate transactions other than the avoidance of sales tax. However, petitioner concedes that its assertion of the substance of the transaction is inconsistent with some of the terms of the APA and related transfer documents. That is, the APA and related documents show that petitioner sold the subject assets to NAMPAC. Petitioner represents that, contrary to the actual terms of the APA, it made an "internal transfer" of the subject asset to SC Plastics on April 30, 2001, and then made a separate sale of its member interests in SC Plastics to NAMPAC on June 29, 2001. Thus, according to petitioner, it could not have sold the Ontario capital assets to NAMPAC on June 29, 2001, because it had already made the "internal transfer" of those assets to SC Plastics on April 30, 2001.

Petitioner states that its transfer to SC Plastics was done to create several possible alternative methods for petitioner to dispose of its North American assets to NAMPAC or to any other potential purchaser without the approval of the landlord for the Ontario premises. Apparently, the landlord was reluctant to approve any assignment of the leasehold interests, but an assignment of the leasehold interest to "related persons" did not require the landlord's approval. Petitioner states that the language about petitioner selling its tangible personal property interests, including the capital assets located at the Ontario plant on June 29, 2001, was inserted in the APA and related transfer documents solely to meet requirements of NAMPAC's lenders so that they would have the priority security interests in the subject assets which they demanded as a condition to making the loans necessary for the transaction.

As indicated in the SD&R, we find that petitioner failed to show that it actually transferred the assets to SC Plastics, or that SC Plastics actually operated the Ontario plant as petitioner alleges. Rather, we find that, consistent with the APA and related documents, petitioner actually owned the subject assets prior to the APA, and that petitioner sold those assets to NAMPAC as provided in their agreement. That is, petitioner actually made but one transfer of the subject assets, a retail sale directly to NAMPAC on June 29, 2001. Accordingly, the step transaction doctrine is not relevant to the resolution of this matter since it applies only when there are two or more transactions to accomplish the desired end result.

We note also that there has been no allegation we are aware of that NAMPAC's lenders did not acquire the priority security interests they sought as a condition to making the loans, which they presumably would not have obtained unless, consistent with the actual terms of the APA on which the lenders apparently relied to make their loans, petitioner was actually the seller of the subject assets to NAMPAC. Any other result would have been fraudulent as to the lenders. We have no reason to believe that either petitioner or NAMPAC was not operating in complete good faith, and thus have no reason to disregard the explicit provisions of their contract of sale. We therefore find that petitioner sold the subject assets to NAMPAC. Accordingly, since that sale was at retail and no exemption applicable, sales tax applies to the gross receipts petitioner received from the sale of the subject assets.

Issue 2: Whether the selling price of the subject assets is overstated in the audit. We recommend no adjustment.

The Department concluded that the $6,746,835 reflected in Schedule 3.2 of the APA as the selling price of equipment as the gross receipts from the sale of the subject assets. Petitioner now contends that the selling price was approximately $2.7 million. Petitioner asserts that it and NAMPAC allocated $25 million of the total purchase price to all of the tangible assets of petitioner's business, including property at other locations, and that NAMPAC eventually created a balance sheet, based on NAMPAC's opinion of the market value of those assets, identifying only approximately $2.7 million for the Ontario plant capital assets.

We find that the best available evidence shows an arm's length agreed sale price of $6,746,835 for the capital assets located at the Ontario plant, based on Schedule 3.2 of the APA.

AMNESTY

The amnesty interest penalty is not applicable in this case because petitioner filed an application for amnesty and entered into a qualifying installment payment plan.

OTHER DEVELOPMENTS

None.

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