OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011891
	CDTFA Account No. 102-097975
TODD A. WELKER	CDTFA Case ID 869819
	Date Issued: March 5, 2019

OPINION

Representing the Parties:[1]

For Appellant:	Jesse W. McClellan, Esq. Lucian Kahn, Esq.
For Respondent:	Joseph Boniwell, Tax Counsel Monica Silva, Tax Counsel IV

M. GEARY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Todd A. Welker (appellant) appeals an action by respondent California Department of Tax and Fee Administration (Department), or by its predecessor, the Board of Equalization (Board), determining appellant is liable as a successor for the unpaid liabilities of Beverly Bagels, Inc. (BBI) for the period April 1, 2005, through July 10, 2011, pursuant to R&TC sections 6811 and following.

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Jeffrey G. Angeja, and Sara A. Hosey, held an oral hearing for this matter in Van Nuys, California, on December 11, 2018. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Is appellant liable as a successor for the unpaid liabilities of BBI for the period April 1, 2005, through July 10, 2011, pursuant to R&TC sections 6811 and following?

[1] The parties, Todd Welker, appellant, and Kevin Hanks, representing the California Department of Tax and Fee Administration, also attended the hearing.

FACTUAL FINDINGS

1. 17th Street Café (the café), a restaurant in Santa Monica, California, was at one time owned by 17th Street Café, Inc. (17th Street). A Board audit determined that 17th Street was liable for unpaid taxes and interest. Montana Avenue Restaurant, Inc. (Montana) purchased the café from 17th Street and was later found to be liable for 17th Street's unpaid tax liabilities as a successor. When Montana sold the café to BBI, there was an unpaid liability of $120,542.87. BBI was later found to be liable for Montana's unpaid tax liabilities as a successor. A subsequent Board audit of BBI determined a liability of $322,753 tax, interest, and a negligence penalty.
2. On or before June 30, 2011, BBI, as the seller, and appellant, on his own behalf or for a limited liability company (LLC) not yet in existence, negotiated the principle terms for the sale/purchase of the café.
3. At the time of the negotiations for the sale/purchase of the café, appellant informed BBI that he planned to set up an LLC with the name "Smoochie Management, LLC" (Smoochie or the LLC).[2]
4. At the time of the negotiations for the sale/purchase of the café, BBI's unpaid tax liabilities (tax and interest) exceeded $440,000. Subsequent payments reduced that liability to $388,370.90 tax, plus interest.[3]
5. On June 30, 2011, BBI executed a Bill of Sale of the restaurant, which acknowledges receipt of $710,000 and purports to transfer to Smoochie Management, LLC, the restaurant's trade name, good will, fixtures, furniture, equipment, inventory, leasehold interest, liquor license, and a covenant not to compete.
6. On July 1, 2011, BBI, as the seller, accepted an offer by appellant or "his wholly-owned affiliate" to buy the café for $225,000 down and an additional $485,000 in installments. At that time, there was a contract for the sale and purchase of the café (the Contract).
7. Also on July 1, 2011, the parties to the Contract opened an escrow to better ensure the timely and proper performance of their respective obligations under the Contract. Escrow

[2] This is the LLC name shown in Secretary of State records. Some evidence in this appeal refers to "Smoochies Management, LLC." We will use only the former name, even when the latter name is used in the document under consideration.

[3] The Board imposed a $32,275.31 negligence penalty on BBI after the sale at issue here. That penalty was not included in the determination issued to appellant.

documents identify BBI as the seller and appellant as buyer and set an August 30, 2011 escrow closing date.

8. The original escrow instructions, signed by BBI and appellant, stated that the consideration to be paid by the buyer was $710,000, which was to consist of buyer's $5,000 initial escrow deposit, a second $100,000 deposit by July 6, 2011, assumption of a "$485,000 private note of record," and assumption of a "$120,000 Board lien of record." Appellant deposited $5,000 into the escrow on July 1, 2011. The reference to a "$120,000 Board lien of record" refers to a liability imposed on BBI as a successor of Montana.

9. The original escrow instructions also informed appellant regarding the need for a Certificate of Payment (tax clearance) from the Board, the possible need for an instruction to the escrow holder to withhold funds from the seller in the event tax clearances were not obtained, and the risk that the Department will attempt to impose liability for unpaid taxes on appellant as a successor to BBI.[4]

10. On or after July 1, 2011, the escrow officer sent the Board a request for a tax clearance.[5]

11. Appellant deposited an additional $220,000 into escrow on July 5, 2011.

12. On July 5, 2011, appellant, as managing member of Smoochie, as debtor, executed a $486,376.11 installment note and Security Agreement in favor of Montana. The security agreement granted Montana a security interest in certain personal property as security for payment of the note.[6]

[4] A Certificate of Payment, or tax clearance, was issued by the Board to inform prospective business buyers of an existing tax liability of a business seller. (See R&TC, § 6812, discussed below.)

[5] Although the parties did not provide a copy of the request, the escrow was established on July 1, 2011, and the Board responded to the escrow officer's request on August 4, 2011.

[6] It is undisputed that Smoochie did not exist on July 5, 2011, and it is not clear why Smoochie (or appellant) would have executed a note payable to Montana for what appears to be the entire deferred payment when there remained an outstanding $120,000 tax liability attributable to Montana.

13. On July 6, 2011, BBI, appellant, and Ms. Mariya Sheveleva, entered into an agreement with the owner of the property on which the café was situated to allow BBI to assign the lease to appellant and Ms. Sheveleva.[7]

14. Smoochie filed its LLC Articles of Organization on July 7, 2011. It was a two-member LLC with each member, appellant and Mariya Welker, having an equal interest and management responsibility.

15. A July 7, 2011 "Modification to Original Bulk Escrow Instructions," signed by BBI and appellant, states that the seller agreed to allow buyer to take possession of and operate the café beginning on July 11, 2011, which was prior to the escrow closing date. The modification also states that appellant was aware that the escrow holder had not received the required clearances, that there was an existing tax lien of record, and that, while Montana agreed to indemnify BBI, and will agree to indemnify appellant from Montana's unpaid tax liabilities, the Board does not release him. The modification specifically informed Appellant that the Board's position was that if the tax lien was not paid in full through the purchase of the business, the buyer would become personally liable as successor to BBI.

16. On July 7, 2011, appellant, purportedly on behalf of Smoochie, instructed the escrow to release the bulk of the purchase funds to BBI on July 11, 2011.

17. On July 8, 2011, appellant applied for a sole proprietor's seller's permit with a July 11, 2011 effective date, and BBI asked the Board to close its seller's permit effective July 10, 2011. Appellant applied for the seller's permit in his name because Board staff informed him that he could not apply for a seller's permit in the LLC's name until he could provide evidence that the LLC had been properly registered with the Secretary of State.

18. Appellant took possession of and began to operate the café on July 11, 2011.

19. Appellant deposited an additional $13,000 to escrow on July 11, 2011.

20. The escrow released the purchase funds to BBI on July 11, 2011.

21. In a July 12, 2011 "Modification to Bulk Sale Escrow Instructions," appellant relinquished and assigned to Smoochie all of his rights to purchase the café and its assets.

[7] In his hearing brief, appellant identifies his wife as "Mariya," but he does not explain whether his wife was Mariya Sheveleva or Mariya Welker (see below), or whether those are different names used by the same person.

22. On July 20, 2011, the escrow officer requested publication of a fictitious business name statement in the Los Angeles Bulletin. The statement, which was to run on four consecutive Wednesdays beginning July 20, 2011, identified appellant as the individual who was doing business as the café and states that he began business on July 11, 2011.

23. On August 22, 2011, the escrow officer requested publication of another fictitious business name statement in the Los Angeles Bulletin. The statement, which was to run on four consecutive Mondays beginning on August 22, 2011, identified Smoochie as the entity that was doing business as the café and states that the LLC commenced business on June 30, 2011.

24. On August 4, 2011, the Board responded to the escrow officer's request for a tax clearance. The response indicates an outstanding liability for the period October 8, 2007, through July 10, 2011 of $710,000. It informed BBI that it must pay the amount as a condition for releasing the tax clearance mailed to the escrow; and it informed appellant that, if the amount was not paid, he may be liable as a successor.

25. On August 23, 2011, appellant and Mariya Welker signed an application for a seller's permit on behalf of Smoochie. The application states that the LLC began business on July 11, 2011, that the LLC was not buying an existing business, and that the application was due to a change from one type of business organization (individual or sole proprietorship) to another (corporation or LLC). In the area of the permit application reserved for the use of Board staff, it states that the permit would issue on August 23, 2011.

26. The seller's permit issued to Smoochie for the café states that it was effective July 11, 2011.

27. Smoochie, BBI, Montana, the various owners of those entities (including appellant), and apparently others, including the broker for the business sale and the escrow company, were involved in litigation concerning the sale of the café, the unpaid tax liabilities, and other issues.[8] The parties to that litigation settled the dispute. According to the settlement agreement, BBI paid appellant $75,000, and appellant and Smoochie agreed to relinquish all interest in the café effective January 14, 2013. The settlement included

[8] We have no evidence that identifies all parties to that litigation. However, appellant provided a copy of the settlement agreement, which includes language that released BBI, Montana, the owners of those entities, the escrow company, the escrow agent, and the broker.

mutual releases of all claims that might have existed as of the date of the settlement, not just those raised in the litigation.

28. On January 29, 2013, the Department timely issued a Notice of Successor Liability to appellant for $440.370.90 tax, plus accrued interest. After allowing credit for payments made, that liability currently stands at $388,370.90, plus interest.

29. Appellant did not timely file a petition for redetermination of the liability, but the Department accepted appellant's late petition as an administrative protest.

30. On August 17, 2017, the Department's Appeals Bureau issued a Decision and Recommendation reducing appellant's liability to $163,000 based on what the Appeals Bureau characterized as an erroneous concession by the Department.

31. The Department withdrew its concession and filed a timely request for reconsideration. On November 16, 2017, the Appeals Bureau issued a Supplemental Decision and Recommendation reinstating the original liability without the previously conceded adjustment. This timely appeal followed.

DISCUSSION

R&TC section 6811 states, "If any person liable for any amount under this part sells out his business or stock of goods or quits the business, his successors or assigns shall withhold sufficient of the purchase price to cover such amount until the former owner produces a receipt from the [B]oard showing that it has been paid or a certificate stating that no amount is due." If the buyer fails to withhold from the purchase price as required by section 6811, the buyer becomes personally liable to the extent of the purchase price. (R&TC, § 6812(a); see also Cal. Code Regs., tit. 18, § 1702.) During the relevant time, the law provided that, within 60 days after (1) the Board receives a written request from the buyer for a certificate, (2) the date of the sale of the business or stock of goods, or (3) the date the former owner's records are made available for audit, whichever occurs later, the Board must either issue the certificate or mail notice of the amount that must be paid as a condition of issuing the certificate. (R&TC, § 6812(b).) Failure of the Board to mail the notice referred to in section 6812(b) will result in a release of the buyer from any further obligation to withhold funds from the purchase price. (R&TC, § 6812(c).)

Appellant argues that he always intended to first form an LLC and then purchase the café using the LLC. He argues that the seller and the escrow company understood this was his intent,

and he contends that he did everything he could to do what he intended. Finally, appellant asserts that the evidence shows that he did accomplish what he set out to do: Smoochie was the buyer of the business from the beginning; the successor liability the Department asserts against appellant should have been asserted against the LLC; and the determination issued against him is a desperate attempt by the Department to minimize its losses.

Statutory compliance is not usually determined by what someone intended to do. It is determined by what was done. Thus, the primary question here is not whether appellant intended that Smoochie purchase the café from BBI. The question is who purchased the café from BBI.

It is undisputed that Smoochie did not come into existence until July 7, 2011. Even if we were to consider the July 1, 2011 purchase offer to have been an offer by appellant or his then nonexistent "wholly-owned affiliate," the parties agree that the offer was accepted by BBI on July 1. The Contract between appellant and BBI thus came into existence. There are contingencies in the offer (e.g. lease assignment, covenant not to compete, etc.), but there is nothing in the Contract to suggest that it was contingent on appellant creating the LLC or the LLC taking some action, such as ratification. Appellant does not argue there was. Thus, we conclude that on July 1, 2011, appellant agreed to purchase the café.

The fact that BBI and appellant entered into the Contract on July 1, 2011, did not prevent the contracting parties from changing the terms of the agreement before the sale. The parties had not yet performed pursuant to their mutual promises. The escrow was set up to ensure proper and complete performance, and if the parties to the Contract wanted to change the identity of the buyer, the escrow should have been able to facilitate that. The question is whether that happened and, if so, whether the change occurred before successor liability attached to appellant at the moment the sale was completed.

While the evidence suggests that the parties to the Contract planned to allow Smoochie to complete the purchase, the weight of the evidence shows that appellant completed the purchase of the café and that successor liability attached to him as an individual.[9] Prior to July 12, 2011, the escrow identified appellant as the buyer. While the escrow officer testified that she understood from the beginning that appellant would be forming an LLC to complete the purchase, the fact remains that, according to the evidence, the only relevant purchase contract was the Contract between appellant and BBI. The escrow was to ensure proper performance of

[9] The question of whether Smoochie may also have been a successor is not before us.

that contract only.[10] Before the LLC came into existence, appellant deposited $225,000 into the escrow, executed a $486,376.11 installment note and Security Agreement in favor of Montana on behalf of a nonexistent entity, and entered into an agreement to allow BBI to assign the café's lease to appellant and Ms. Sheveleva. The steps appellant took as an individual to purchase the café did not end with the registration of the LLC on July 7, 2011. On that same day, appellant and BBI modified the escrow instructions to allow appellant (not Smoochie) to take possession of and operate the café beginning on July 11, 2011. Also on July 7, 2011, appellant instructed the escrow officer to disburse the bulk of the purchase funds to BBI. Although appellant purportedly signed the instruction on behalf of Smoochie, the LLC was not a party to the contract and had no standing or authority to instruct the escrow officer to release funds. On July 8, 2011, appellant obtained a seller's permit to operate the café as a sole proprietor, and by July 11, 2011, appellant took possession of and began operating the café. With substantial performance of the Contract completed by July 11, 2011, the sale was completed. Appellant owned the business and successor liability attached to him by July 11, 2011.

We are not persuaded by appellant's argument that Smoochie was substituted in the place of appellant as the buyer under the Contract before the sale to appellant was completed. The Contract establishes the terms of the purchase agreement. The seller was BBI, and the buyer was appellant. The Contract states that the buyer would be appellant or his wholly-owned affiliate, and that the contract could be amended at any time by a writing signed by the seller and the buyer. However, as we have already found, appellant was the buyer under the Contract on July 1, 2011, and he remained the buyer at the time the sale was completed. The escrow officer testified that she was told on July 7, 2011, that Smoochie should be substituted as the buyer, but that statement does not prove a modification of the Contract.[11] The statement is hearsay and we have no evidence that there was a modification to the Contract on July 7, 2011, or at any time before the sale to appellant was completed. While the July 12, 2011 modification to the escrow instructions purports to substitute Smoochie for appellant as the buyer, this occurred after the sale was completed.

[10] There is nothing in the evidence to even suggest that the escrow company could have established an escrow to which the then nonexistent LLC could have been a party.

[11] We note that the escrow officer took no action to change the escrow until she had specific written instructions for the seller and buyer.

We understand that much of what appellant did in connection with the purchase was done by him, as an individual, because he had not yet set up and registered the LLC. We do not doubt that Board staff informed appellant that the Board would not issue a seller's permit to a nonexistent entity. We also understand that it may have been appellant's intent to form the LLC and have the LLC purchase the café. Nevertheless, appellant made the choices and took the actions that completed the sale and caused liability to attach. Had appellant allowed the escrow to run its 60-day course, there would have been time to set up the LLC, substitute the LLC for appellant as the buyer, obtain the tax clearance, and protect the interests of the Board while also protecting appellant from the liability at issue here. But that is not what he did. Appellant accelerated the timetable for transfer of the café and release of the funds, failed to allow the Board an opportunity to respond to his request for a tax clearance;[12] ignored the clear warnings in the July 7, 2011 "Modification to Original Bulk Escrow Instructions" about BBI's unpaid tax liabilities, authorized the release of the purchase funds to BBI, and, finally, released everyone to whom he might have looked for indemnification in exchange for $75,000.

Based on the evidence, we find that appellant is liable as a successor for the unpaid liabilities of BBI for the period April 1, 2005, through July 10, 2011, pursuant to R&TC sections 6811 and following.

HOLDING

Appellant is liable as a successor for the unpaid liabilities of BBI for the period April 1, 2005, through July 10, 2011.

[12] The request was sent by the escrow officer, but it was sent for the benefit of the buyer, appellant.

DISPOSITION

We sustain the Department's determination.

DocuSigned by:
1A9B52EF88AC4C7...
Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
0D390BC3CCB14A9...
Jeffrey G. Angeja
Administrative Law Judge

DocuSigned by:
6D3FE4A0CA514E7...
Sara A. Hosey
Administrative Law Judge