OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18114030
	) CDTFA Case ID: 1007867
Q. ZHENG	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Linda T. Sung, Attorney
For Respondent:	Courtney Daniels, Tax Counsel III Chad Bacchus, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Q. Zheng (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] partially denying appellant's petition for redetermination of a Notice of Successor Liability (NOSL) dated April 14, 2017. The NOSL is for a tax of $32,182.67, plus applicable interest, and penalties of $7,570.05, for the period October 1, 2013, through September 8, 2015 (liability period). On October 29, 2018, CDTFA issued its aforementioned decision holding appellant personally liable as a successor for the unpaid liabilities of Don Day, Inc., relieving appellant's personal liability for the penalties, and otherwise denying the petition.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Keith T. Long held an oral hearing for this matter electronically, on February 24, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

ISSUE

Whether appellant is liable as a successor for the unpaid sales tax liability of a predecessor business.

FACTUAL FINDINGS

1. On or about July 10 2015, appellant purchased a Los Angeles area restaurant doing business as Don Day (the business) from Don Day, Inc. (Predecessor).
2. According to the Bill of Sale dated July 10, 2015, appellant purchased all of the equipment, fixtures, furniture, goodwill, tradename, lease, and leasehold improvements for the business. On that same day, appellant signed a document titled "Escrow Instructions Sale of Business with Transfer of Liquor License" (escrow instructions), which required appellant to place consideration of $230,000 in escrow for the purchase of the business.
3. As relevant here, the escrow instructions state:

> TAXES. Unless specifically instructed in this escrow, Escrow Holder is not to be concerned with any unpaid beverage, unemployment, social security, personal property, or retail sales tax or sales tax on fixtures, equipment, etc., being sold, or any other tax or contributions or any unpaid salaries or wages, even though Buyer may be personally liable for payment thereof. IF DIRECTED TO MAKE ANY SUCH PAYMENT, SAME MAY OR MAY NOT CONSTITUTE FULL OR FINAL PAYMENT THEREOF.

4. On or about September 9, 2015, appellant signed a form titled Amended Escrow Instructions,[2] (amended escrow) which authorizes the closure of the escrow. As relevant here, paragraph number 12 of the amended escrow states the following:

> **WITHHOLD SELLER'S PROCEEDS UNTIL RELEASE FROM STATE BOARD OF EQUALIZATION AND EDD:** Seller will furnish CERTIFICATE OF RELEASE OF PAYMENT OF SALES AND USE TAX from the State of California Board of Equalization . . . if necessary. Escrow Holder is instructed to withhold the sum of $11,500 from Seller's proceeds at the close of escrow until said releases have been deposited. In the event that the said releases are not deposited into escrow within 60 days after close of escrow and Escrow Holder is in receipt of demand(s) from the

[2] During this appeal, OTA found that pages 1 and 3 of the documents are dated September 9, 2015, and page 2 is dated September 10, 2015. OTA requested that appellant explain the different dates. In reply, appellant confirmed that she only signed the Amended Escrow Instructions one time. Appellant asserts that the difference between pages is either the result of a typo or the result of the escrow company making changes after the document was signed. OTA sees no reason to find that the date discrepancy is anything other than a typographical error.

> above agencies, Escrow Holder is authorized and instructed to pay such demand(s) without further instructions. Further, in the event that the said 60-period has gone by and the demands have been received from both of the above agencies, Escrow Holder is to pay the said demands pro rata. The parties agree that it is seller's sole responsibility to obtain the aforementioned release(s). In the event that the funds required to obtain the aforementioned release(s) proved to be more than the funds held by Escrow Holder, Seller shall, if necessary, deposit sufficient funds into escrow to obtain the release(s).

The amended escrow also gave appellant possession of the business as of September 9, 2015. This is corroborated by a seller's closing statement, which indicates a closing date of September 9, 2015. The seller's closing statement indicates that the escrow company was required to withhold $11,500 from Predecessor's proceeds for payment to CDTFA or the California Employment Development Department.

5. On January 11, 2016, CDTFA received a tax clearance certificate request (clearance request) from the escrow company.[3] The clearance request lists the business's sale price as $230,000. Appellant is listed as the buyer of the business.

6. On January 25, 2016, CDTFA issued a Notice of Amounts Due and Conditional Release to the escrow company stating that there was a tax due of $230,000 (the purchase price of the business).[4] On the same day, CDTFA contacted Predecessor to obtain books and records for an audit of the liability period.

7. Predecessor did not provide any books or records for the audit. For the audit, CDTFA obtained the following: a copy of Predecessor's 2013 California income tax return; credit card transaction data reported on Predecessor's 2013 and 2014 IRS Forms 1099-K.[5]

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[3] The tax clearance certificate request is dated September 10, 2015. However, there is no dispute that CDTFA first received the tax clearance certificate request via fax on January 11, 2016.

[4] Upon the sale and purchase of a business, the purchaser is required to withhold a sufficient amount (up to and including the purchase price of the business) to cover the tax liability of the former owner unless the former owner produces a receipt or certificate from CDTFA showing that the tax has been paid. (R&TC, § 6811.) CDTFA included the full purchase price of the business in its Notice of Amounts Due and Conditional Release, which was issued prior to the audit of Predecessor's business. After the audit, CDTFA issued a Notice of Determination to Predecessor and NOSL to appellant, which included a reduced tax liability.

[5] Form 1099-K is an IRS Form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third-party network, during a given time period. Form 1099-K includes payments made by any electronic means, including but not limited to credit cards, debit cards, and PayPal.

Based on this information, CDTFA found that Predecessor failed to report taxable sales during the liability period measuring $485,361.[6]

8. On December 7, 2016, CDTFA issued a second Notice of Amounts Due and Conditional Release reducing the amount due to $43,683.00, plus applicable interest, and a penalty of $4,368.30.

9. On December 20, 2016, CDTFA issued a Notice of Determination (NOD) for the liability period to Predecessor for $43,682.67 tax, plus applicable interest, and penalties. Predecessor did not file a timely petition for redetermination or pay the liability within 30 days and it became final. On January 4, 2017, CDTFA issued a revised Notice of Amounts Due and Conditional Release to the escrow company reflecting the amount shown in the NOD.

10. On February 14, 2017, the escrow company made a payment to CDTFA of $11,500 (i.e., the amount that the escrow company was required to withhold, according to the amended escrow instructions and seller's closing statement.)

11. On April 14, 2017, CDTFA issued the aforementioned NOSL for the liability period. Appellant filed a timely petition for redetermination disputing the NOSL, which CDTFA denied on October 29, 2018.

12. This timely appeal followed.

DISCUSSION

R&TC section 6811 provides that if a person who has a sales tax liability sells its business or stock of goods, or quits the business, its successor shall withhold a sufficient amount of the purchase price (up to the amount of the purchase price of the business or stock of goods) to cover the tax liability of the former owner unless the former owner produces a receipt or certificate from CDTFA showing that the tax liability has been paid. This requirement arises only in the case of the purchase and sale of a business or stock of goods under a contract, providing for the payment to the seller or designated person of a purchase price in money or property or providing for the assumption of liabilities and only to the extent thereof and does not arise in connection with other transfers of a business such as assignments for the benefit of

[6] CDTFA's calculation of the liability and Predecessor's unreported taxable sales is not in dispute. Accordingly, OTA will not discuss it further.

creditors, foreclosures of mortgages, or sales by trustees in bankruptcy. (Cal. Code Regs. tit. 18, § 1702(a).)

If the purchaser of a business or stock of goods fails to withhold from the purchase price as required, he or she becomes personally liable for the payment of the amount required to be withheld by him or her to the extent of the purchase price, valued in money. (R&TC, § 6812(a).) The liability of the successor or purchaser of a business or stock of goods includes all tax, interest, and penalties incurred by the former owner as a result of operating the business. (Cal. Code Regs. tit. 18, § 1702(b).) Neither R&TC section 6811 nor R&TC section 6812 requires that a purchaser be aware of the seller's outstanding tax liability or expressly assume the seller's debts for successor liability to attach.

The purchaser of the business or stock of goods will be released from further obligation to withhold from the purchase price if they obtain a certificate from CDTFA stating that no taxes, interest, or penalties are due from a predecessor. (Cal. Code Regs. tit. 18, § 1702(c).) The purchaser also will be released if they make a written request to CDTFA for a certificate and CDTFA does not issue the certificate, or mail to the purchaser a notice of the amount of the tax, interest, and penalties that must be paid as a condition of issuing the certificate, within 60 days after the latest of the following dates: (1) the date CDTFA receives a written request from the purchaser for a certificate; or (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. (*Ibid*.)

Here, appellant signed a bill of sale dated July 10, 2015, for the purchase of Predecessor's equipment, fixtures, furniture, goodwill, tradename, lease, and leasehold improvements. Appellant also signed the amended escrow, which states that the transfer of Predecessor's liquor license and property-lease were transferred to appellant as of September 9, 2015. The evidence shows that appellant was entitled to take possession of the business on that day. Based on these facts, OTA finds that appellant's purchase included substantially all of the essential elements of the business including seller's tangible assets (furniture, equipment, etc.) and intangible assets (goodwill, tradename). Therefore, OTA concludes that appellant purchased the business.

Accordingly, appellant was required to either withhold amounts from the purchase price sufficient to pay Predecessor's liability or to obtain a certificate of clearance from CDTFA showing that no tax was due. (R&TC, § 6811, Cal. Code Regs. tit. 18, §1702.) It is undisputed that CDTFA received a clearance request from the escrow company on January 11, 2016.

However, there is no evidence that CDTFA issued a certificate of clearance showing no amounts due. Instead, CDTFA issued Notices of Amounts Due and Conditional Release to the Escrow in the amount of $230,000. As discussed above, the escrow company withheld $11,500 from the purchase price for the payment of Predecessor's tax liability, which was not sufficient to cover the Predecessor's liability. Consequently, appellant, as the successor, is liable for the balance due. (R&TC, § 6812; (Cal. Code Regs., tit. 18, § 1702(c).)[7]

Despite this, appellant contends that she cannot be held liable as a successor. Appellant argues that the duty to withhold the tax only arises "in the case of purchase and sale of a business under a contract." (Citing Cal. Code Regs. tit. 18, §1702(a) [*emphasis added by appellant*].) Appellant asserts that she rescinded the contract with Predecessor, and as a result, there was no duty to withhold the tax under R&TC section 6811.

Citing California Civil Code section 1572 and 1689, appellant asserts that she rescinded the contract with Predecessor as a result of actual and constructive fraud. In support of the argument that fraud occurred, appellant asserts the following: (1) the seller, the sales broker, and the escrow company colluded to defraud appellant into signing the sales contract; (2) the sales broker and the escrow company knew or should have known that they have a duty to obtain a tax clearance from CDTFA; (3) unbeknownst to appellant, the escrow company added a disclaimer clause to the escrow instructions and the amended escrow instructions stating that "[appellant] is willing to release all funds from and take the risk for any and all prior tax debts;" (4) the sales broker failed to inform appellant of the risks involved in closing escrow without a clearance certificate; (5) the escrow company deliberately delayed sending a September 10, 2016 tax clearance request to CDTFA until January 11, 2016, with the intent to deceive appellant; and (6) the escrow company received an NOD from CDTFA for the total amount of tax due but only paid $11,500.

Although appellant argues that the contract was rescinded, appellant also states that she continued to own and operate the business after the alleged rescission. At the oral hearing, appellant asserted that she attempted to rescind the contract, but Predecessor was unavailable. Appellant states that she maintained control of the business, that she did not receive a refund of

[7] Predecessor is not liable for tax to the extent that R&TC section 6812 imposes the liability on a successor, and the successor pays the tax. However, Predecessor may still be held responsible for the sales tax under R&TC sections 6012 and 6051, which impose the sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. CDTFA may only collect the liability once, regardless of whether Predecessor or appellant pays it.

the purchase price, and that it would be cost prohibitive to seek rescission through legal proceedings.

A contract is extinguished by its rescission. (Civ. Code, § 1688.) Rescission is accomplished by giving notice to the other party to the agreement and restoring or offering everything of value received. (Civ. Code, § 1691.; see also *Little v. Pullman* (2013) 219 Cal.App 4th 558, 566, citing *Larsen v. Johannes* (1970) 7 Cal.App.3d 491, 503.) Once a contract has been rescinded it is void *ab initio,* as if it never existed. (*Little v. Pullman*, *supra*, at 568.) As relevant here, rescission may occur if all the parties to an agreement consent to the rescission. (Civ. Code, § 1689(a).) A party to a contract may also rescind the contract if the consent of the party rescinding, or of any party jointly contracting with him, to enter the contract was given by mistake, or obtained through duress, menace, fraud, or undue influence, exercised by or with the connivance of the party as to whom he rescinds, or of any other party to the contract jointly interested with such party. (Civ. Code, § 1689(b).) When a contract has been rescinded in whole or in part, any party to the contract may seek relief based upon such rescission by (a) bringing an action to recover any money or thing owing to him or her by any other party to the contract as a consequence of such rescission or any other relief to which they may be entitled under the circumstances or (b) asserting such rescission by way of defense or cross-complaint. (Civ. Code, § 1692.)

With respect to the alleged rescission, OTA first notes that appellant did not return the business to Predecessor. To the contrary, appellant concedes that she maintained control and continued to operate the business. Instead, appellant contends that she offered to rescind the contract. In support, appellant provided a letter from her attorney demanding (demand letter) that Predecessor pay the tax. However, the demand letter only threatens legal action for damages. The demand letter does not offer or create rescission of the contract. Similarly, appellant provided telephone records, asserting that she contacted Predecessor and the escrow company, but nothing in the telephone records indicates that an offer of rescission was made. Instead, the telephone records only show that appellant made a telephone call to the same number on several occasions. There is no way for OTA to even confirm the owner of the telephone number from the telephone records. Therefore, OTA cannot conclude that appellant restored or offered to restore the business to Predecessor.

Furthermore, appellant admittedly did not seek recission through the courts because it would be "cost prohibitive" to do so. Thus, in the absence of any evidence that appellant restored, or even offered to restore, the property to Predecessor, or to take court action against Predecessor, OTA finds that no rescission occurred.

Regarding whether there was fraud by the escrow company, appellant has not provided any evidence of collusion between the seller, the broker, and the escrow company. Unsupported assertions are insufficient to meet appellant's burden of proof. (*Appeal of Talavera*, *supra*.) Even if appellant were defrauded, appellant's remedy would be to seek relief from the party that defrauded her (i.e., Predecessor or escrow company) by bringing an action through the court as required by Civil Code section 1692. OTA is not a court and does not have jurisdiction to provide a remedy to appellant on these grounds. Rather OTA is an administrative agency, and its jurisdiction concerns appeals from actions by the Franchise Tax Board and CDTFA. (See Cal. Code Regs., tit. 18, § 30103.) Thus, although appellant may have entered into an unfavorable agreement, OTA lacks jurisdiction to determine whether the contract was rescinded based on fraud.

HOLDING

Appellant is liable as a successor for the unpaid sales tax liability of a predecessor business.

DISPOSITION

CDTFA's action in denying the petition for redetermination is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Josh Aldrich
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 4/19/2023