EXEMPT TRANSACTIONS
OCCASIONAL SALE AND SUCCESSOR'S LIABILITY

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<u>INTRODUCTION</u>

This section deals with the audit methods and procedures to be used on sales and use tax audits in the areas of occasional sale and successor's liability.

Read and discuss **KRS 139.470(4)** and **KRS 139.070 – <u>Occasional Sale</u>**.

<u>OCCASIONAL SALE DEFINED</u>

KRS 139.070 provides an exemption from the measure of sales tax for sales that qualify as occasional sales. For a sale to qualify for the occasional sale exemption certain conditions must be met.

Please note that if the sale is deemed to be an occasional sale for the seller, it is an occasional purchase for the purchaser. For example, if a person purchases a refrigerator from an individual then it is most likely that the purchase will qualify as an occasional sale for the vendor which would result in an occasional purchase and not be a taxable event. Also, the purchaser would not be liable for use tax. **(KRS 139.470(4).**

From an audit/review standpoint, the burden is on the purchaser to prove that he/she made an occasional purchase.

If you (the auditor/reviewer) are satisfied that the transaction constitutes an occasional purchase, then treat the purchase as such.

<u>QUALIFYING CONDITIONS</u>

<u>Requirement #1</u>

The **first requirement** that must be met for a sale to qualify for the occasional sale exemption is that the property sold must not be the type of property that would require the seller to hold a seller's permit. Tax applies to all retail sales of tangible personal property held or used by the seller in the course of any selling activity for which a seller's permit is required (selling activities involving the sale of all types of merchandise, taxable services, or admissions). While there is not a specific definition for the term "Selling Activity Assets" in the sales and use tax law or regulations, consider the following:

> "Any assets comprising tangible personal property utilized in a selling activity involving the sale of all types of merchandise, taxable services or admissions are not the subject of an occasional sale.

When the entire business is sold in one transaction that portion of the purchase price attributed to the fair retail value of the **tangible personal property** used in the selling activity must be separately stated. In other words, it is necessary to prorate the selling price of the business according to the taxable and nontaxable assets, i.e., tangible personal property, license agreements, subleases and lease assignment, real estate and leasehold improvements. This proration can be based on the fair market value of the assets or the depreciable base of the purchase. The fact that assets are sold as a result of going out of business would not make the transactions occasional sales.

- **Retail Store**

  A drug store is required to hold a sales tax permit, thus all assets of the drug store are deemed selling activity assets and can never qualify for the occasional sale exemption.

- **Wholesaler**

  Wholesalers have selling assets because they are required to hold a seller's permit and their sales of tangible personal property will be included in the measure of the sales tax when ultimately sold at retail to the final consumer

- **Manufacturer**

  In the case of Revday Industries v. Revenue, the Kentucky Supreme Court determined that there were two distinct activities, a manufacturing activity and a selling activity. A sales tax permit was not required to manufacturer but a permit was required to sell the manufactured product. Accordingly, the court determined that assets used in the manufacturing area could qualify as an occasional sale while assets used in the selling area were subject to tax. The sale of such manufacturing assets could qualify as an occasional sale under **KRS 139.070.** However, the sale of items such as copiers, fax machines, computer equipment and office equipment used in the selling area would be subject to tax. **NOTE:** This same equipment could be non-selling activity assets if located in the plant area and used in the manufacture of the product.

- **Service Entity**

  A service entity that <u>holds a sales tax permit</u> would be subject to tax on the sale of assets used in making retail sales. Such assets could include copiers, fax machines, computer equipment, cash registers and office equipment. However, the sale of assets used in a selling activity would not make the sale of other assets of the service entity used in activities that do not require the holding of a sellers permit subject to tax. For example, a laundry mat holds a sellers permit to sell bleach, detergent etc., from vending machines. While the sale of the vending machines would be subject to tax, the sale of the washing machines and dryers could qualify as an occasional sale. The washing machines and dryers are and remain non-selling activity assets.

To explain further, if a laundry disposes of (sells) all the laundry equipment (iron, ironing boards, pressing equipment, etc.) in a **lump sum sale** the sale would not be taxable as this person is engaged in an activity for which he/she is not required to hold a permit. These are considered non-selling activity assets.

♦ **Taxable Service Sellers**

Examples of these type sellers who have selling assets include: motels, hotels, telephone companies, sellers of admissions and utility companies

To summarize, for a sale to qualify for the occasional sale exemption it is necessary to determine the type of assets sold (i.e. selling activity assets versus non-selling activity assets). Again, if the property being sold has been used in an activity for which a seller's permit was required, the sale cannot qualify as an occasional sale. However, if it is determined that the assets sold are not the type of assets that would require the holding of a sales tax permit further examination of the sale is necessary. However s<u>elling activity assets</u> also do not include accounts receivable of any type, land, real property, goodwill or manufacturing machinery in a plant facility. Tax also does not apply to tangible personal property which represents stock in trade sold by the retailer for the purpose of resale in the regular course of the purchaser's business.

<u>Requirement #2</u>

The **second requirement** involves number, scope, and character. If the sale involves non-selling activity assets, the sale will qualify as an occasional sale unless such sale is one of a series of sales sufficient in **number, scope, and character** to constitute an activity that would require the holding of a sales tax permit.

♦ **"Number"** refers to the <u>actual number of sales made</u>. It is not necessarily the number of items sold but whether or not the items are sold separately or in bulk that indicate that the sale or sales are sufficient in number.

For a sale to count toward the determination of enough sales being made to bring the taxpayer outside the occasional sales criteria, the sale has to be a **sale at retail**. However, the fact a sale may be exempt from tax does not necessarily limit same from being counted as transactions in which title and possession passed to buyers.

A **sale for resale** does not qualify nor does **real estate**.

Sales in interstate commerce do qualify but <u>not</u> sales made outside the state of Kentucky. Sales made outside Kentucky <u>do not</u> include sales originating or terminating in Kentucky.

The sale of a **vehicle** counts although the sale of the asset itself is not subject to **Chapter 139** taxation.

Note: Even if it is a lump sum sale, it is possible that part of the sale of business assets are being held or used by the seller in the course of an activity for which he is required to hold a seller's permit and thus these (selling activity) assets would be subject to tax. They would not fall under the category of occasional sale.

♦ **“Scope”** refers to the dollar amounts received for the items sold. For example, a $2,000,000 piece of equipment probably would not be considered to be of the same scope as a sledgehammer that was sold for $25. “**Character”** refers to the nature of the items sold. For example, if a manufacturer sold three drill presses in a twelve-month period the manufacturer <u>has become a retailer of manufacturing assets</u>, since more than two of these manufacturing assets were sold in a twelve month period.

An example would be the sale of a radio station. During a twelve-month period, the taxpayer made two sales of radio equipment that was worn out. During this same period, the radio station was sold. The sale of the radio station would not be counted as a sale in determining if the taxpayer was a retailer since it was not of the same scope and character as the sale of the worn out equipment. Accordingly, in this situation, both the sale of the worn out equipment and the radio station would qualify as occasional sales.

♦ There is no definition of **“like character”** that will clearly answer the tax status of every situation. Determining what constitutes like character is a matter of subjective judgment. However, generally assets can be considered of like character if the assets are of the same general type, i.e., manufacturing plants even though they may manufacture different products, office furniture even though part may have been used in the manufacturing area, manufacturing equipment even though it may have been used in different areas of manufacturing, furniture and dental equipment in a dentist office, office furniture and electronic equipment in a radio or TV control room and bulldozer and dump truck used in the construction industry.

Note: An asset of the same scope and character used in a selling activity cannot be used to pull in the same type of asset used in a manufacturing area. In other words, a desk in the sales office cannot pull in the desk in the plant area.

On July 14, 1994, **KRS 139.070** was revised to state that in the case of the sale of the entire or substantial portion of the non-selling assets of a seller, the number of previous sales of similar assets shall be disregarded in determining whether or not the current sale or sales qualify for the occasional sale exemption. This merely clarifies that the sale of 2 manufacturing assets cannot be pulled in by a bulk sale of similar assets.

<u>Requirement #3</u>

♦ Another sale that would qualify for the occasional sale exemption, even though the transaction involves selling activity assets, is a sale of substantially all the property held by a person in the course of a business activity when after the sale the **“real** or **ultimate ownership”** of such property **is substantially similar** to that which existed before such transfer. Substantial ownership will remain the same <u>if over fifty percent of the assets are owned by the same individuals both before and after the transfer of the assets.</u> In order for a sale to be considered taxable a change in the majority ownership must have taken place.

To illustrate, assume that Corporation (A), 100% owned by two stockholders, is merged with Corporation (B). After the merger, the stockholders of Corporation (A) own 60 percent of the stock of Corporation (B). In this situation, there has not been a substantial change in ownership and this transaction would be considered nontaxable for sales tax purposes. The reason for this is that before the merger the two stockholders of (A) owned 100% and after the merger 60%. The same stockholders are still majority owners.

To illustrate further, assume the same situation as given in the illustration above, but the stockholders of Corporation (A) now own 30 percent interest in Corporation (B). In this situation, a substantial change in ownership has taken place since only 30 percent of the stock of Corporation (B) is owned by the original stockholders of Corporation (A). Therefore, this transaction is considered taxable. To be taxable it has to be a change in the majority ownership.

TAXABLE/NONTAXABLE SITUATIONS – EXAMPLES

Taxable

The sale of business assets used in the operation of a motel or hotel and selling activities involving the sale of all types of merchandise, taxable services or admissions.

In the case of a manufacturer, the tax will apply to sales of manufacturing assets where more than two (2) retail sales of manufacturing assets have occurred within a twelve (12) month period. Assets used by the manufacturer in selling his product are subject to tax regardless of the number of sales.

In the case of a contractor, a person who normally is not engaged in a selling activity requiring the holding of a seller's permit, sales of construction equipment are subject to tax where more than two (2) retail sales have occurred within a twelve (12) month period.

The exchange of the capital stock of one (1) corporation for the assets of another corporation is considered a taxable transaction provided the assets involved are not the subject of an "occasional sale."

Nontaxable

The sale (less than three (3) sales within a twelve (12) month period) of assets used in an activity not requiring the holding of a seller's permit (such as a sale of manufacturing assets).

Any sale involving the acquisition of capital stock in a corporation where the consideration received is in the form of intangible property (such as cash or stock).

The exchange of capital stock of a corporation for the assets of a proprietorship provided the former owner-proprietor owns a majority interest in the corporation after such exchange.

COURT CASES – OCCASIONAL SALE

WRP Corporation vs. Revenue Cabinet (KBTA) - 1984

The issue dealt with the question of whether or not the sale of a business, the conduct of which requires a sale and use tax permit such as a motel, restaurant or grocery store qualify as an exempt "occasional sale" under **KRS 139.070** and **139.470(4).**

The Cabinet's position was that assets purchased were used in the operation of a motel, restaurant, grocery store, etc. which does require the holding of a sellers permit **(KRS 139.100(2)(a)).** In the case of Commonwealth, ex rel. Luckett v. Revday Industries, Ky. 432 S.W. 2d 819 (1968) the Kentucky Supreme Court stated: "In substance, **KRS 139.070** provides that a sale of property held or used by a seller in the course of the business of selling is not exempt as an occasional sale." Accordingly, the sale of the tangible assets of a motel, restaurant, grocery store, etc., are subject to tax.

The KBTA upheld the Cabinet's position that the sale of a retail sales activity is itself a taxable retail sale. The case was appealed by the taxpayer to the Hopkins Circuit Court which on April 13, 1987, affirmed the Board's decision. Since the taxpayer did not appeal to the Court of Appeals, the case is final.

Revenue Cabinet v. Corum and Company, Inc.

This issue dealt with "what constitutes an occasional sale in regard to number of sales and scope and character of sales.

The Kentucky Court of Appeals held that assets sold as a part of a going out of business transaction were subject to tax and that the fact sales may be exempt from tax does not prevent them from being counted to determine if the taxpayer is a retailer. The fact the assets were sold as a result of going out of business did not make the transactions occasional sales.

A petition for rehearing was denied on November 29, 1985.

East Kentucky Paving, Inc.

At issue was whether the sale made by East Kentucky of certain of its asphalt plants and a majority of its paving equipment to Mountain Enterprises qualified as an "occasional sale", thus exempting the sale of said assets from sales and use tax pursuant to **KRS 139.470(4).** A review of the taxpayer's previous sales and use tax audits and corporation income tax returns filed for the past several years revealed that East Kentucky Paving had previously established itself as a retailer of both manufacturing and construction machinery and equipment. The taxpayer appealed the Cabinet's 4/1/93 final ruling letter to the Kentucky Board of Tax Appeals which found for the Cabinet.

The taxpayer then appealed to the Franklin Circuit Court which also found for the Cabinet. On subsequent appeal, the Kentucky Court of Appeals, in an opinion (not to be published) dated 1/24/97, reversed both the KBTA and Franklin Circuit Court. The Cabinet filed a motion for discretionary review with the Kentucky Supreme Court which was subsequently denied. Accordingly, this case is now final, but the Cabinet's position has not changed.

<u>LWD, Inc. and LWD Equipment, Inc. v. Revenue Cabinet, K97-R-21</u>

Sales tax was assessed by KRC for the taxpayer's leases of equipment to related corporations during the period December 1, 1987, through September 30, 1991. The taxpayer claimed that these transactions were exempt as occasional sales under **KRS 139.070** and **139.470(4).**

In a decision rendered on May 10, 1999, the KBTA upheld KRC's assessment. Sales at retail are taxable and leases are treated under the sales and use tax statutes as sales at retail. The occasional sale exemption set forth in **KRS 139.070(1)(a)** did not apply because the leases in question were of property held by the taxpayer in the course of an activity for which it was required to hold a seller's permit (i.e., leasing of tangible personal property). The occasional sale exemption provision of **KRS 139.070(1)(b)** did not apply either, the KBTA ruled, because none of the leases in question transferred all or substantially all of the taxpayer's property held or used in the course of the activity for which it was required to hold a seller's permit.

The taxpayer appealed the KBTA decision to the Franklin Circuit Court which on July 6, 2000, found for such taxpayer. The Cabinet appealed to the Kentucky Court of Appeals, which ruled in favor of the Cabinet.

In its June 17, 2004, opinion, the Kentucky Supreme Court ruled that the occasional sale exemption did not apply in this case. The Court reaffirmed that "[e]xemptions from taxation are generally disfavored and all doubts are resolved against the exemption." LWD Equipment's interpretation of the occasional sale exemption would "exempt completely from taxation items leased." A lessor could claim first that its initial purchase of an item to be leased was not subject to tax as a purchase for resale under **103 KAR 28:051 § 1(3)** and then assert that the subsequent lease of the item was an exempt occasional sale, regardless of whether the lessor was otherwise engaged in multiple leases on a continuous and ongoing basis. Under this theory, the Court observed, "[a]ny business operation could simply set up a holding company to avoid all sales and use taxes on its equipment."

Accordingly, the Kentucky Supreme Court could not "accept the interpretation by LWD [Equipment] of **KRS 139.070(1)(b)** so as to apply the occasional sale exemption to the multiple, continuous, and ongoing leasing activities in this case." The Court further stated that "[t]he General Assembly has not redefined 'occasional' so as to give it a particular legal meaning that somehow includes transactions that occur frequently and continuously for several years." and that to follow LWD Equipment's interpretation "would make the statute unreasonable and produce an absurd result."

The Kentucky Supreme Court's decision in this case is now final.

TRANSFERS BETWEEN RELATED PARTIES

Facts

Corporation A owns 100 % of Corporations B, C, and D. Corporation B purchases a new miner for $850,000 and places it in service at a Kentucky mine site. Corporation B operates the miner for two (2) years, at which time the miner is no longer needed by Corporation B. Corporation B makes a book transfer of the miner with a net book value of $600,000 to Corporation C.

Corporation C places the miner in service at a different production site and operates the miner for three (3) years before the corporation discontinues production at that location. Corporation C then transfers the miner to Corporation D at a net book value of $225,000.

Corporation D operates a production site in West Virginia and transfers the miner to the West Virginia work site. Corporation D operates the miner for three (3) years at this site, at which time the miner is fully depreciated and has a zero net book value. Corporation D discontinues operations and transfers the miner back to Corporation B, the original owner, at a zero net book value.

Assume all parties have made numerous individual sales during the audit period.

Explanation/Solution

Except for the final transfer, a sale did take place as the transfer(s) were always between separate legal entities and consideration passed between such entities.

Corporations B and C received as consideration the **net book value (cash)** for the miner when it was transferred to the other corporation. In other words, the net book value is treated as the sales price/purchase cost and represents the amount of consideration received. In the transfer from Corporation D to Corporation B, consideration was not present, thus a sale did not take place.

In a related matter, none of the transfers qualified as an occasional sale/purchase under **KRS 139.070(1)(a)** because:

- each entity had established itself as a retailer of non-retail (manufacturing) assets, and;
- the individual transfers did not constitute a transfer of all or substantially all of the companies assets.

GENERAL OVERVIEW – SUCCESSOR'S LIABILITY

General Information

All purchasers or prospective purchasers (successors) of existing Kentucky retail businesses should be aware of the "successor's liability" provision of the law and its implications. Successor's liability is a tax indebtedness provided in **KRS 139.670** and **KRS 139.680**.

Under these statutes, an individual or corporation that purchases an existing retail business, or a stock of goods from a retail business, may be liable for sales and use tax due the state, even though the tax liability was incurred by the retailer prior to the date of the sale. Successor's liability does not apply to business transfers such as assignments for the benefit of creditors, foreclosures of mortgages or sale by trustees in bankruptcy.

Withholding Responsibilities (KRS 139.670)

Whenever a retail business is sold, the purchaser is required to withhold a sufficient amount from the purchase price to cover any of the seller's existing sales and use tax liabilities including interest and any applicable penalties.

The amount withheld should be kept in escrow until the former owner provides the buyer with a letter from the Department of Revenue stating that no taxes, interest, or penalties are due from a predecessor.

The request for tax clearance should be mailed directly to the Sales and Use Tax Section. A request from the prospective buyer will be honored only if the seller instructs the Department of Revenue to send the information to a third party.

> A certificate will be issued provided the seller has no outstanding sales and use tax liability.
>
> The seller of the business may obtain a certificate of tax clearance by submitting a written request to the Department of Revenue. The seller need only provide the Department with the name of the business seeking clearance and the associated sales and use tax permit number.
>
> A certificate of tax clearance may also be obtained by the purchaser, or a representative appointed by the purchaser. Prior to the issuance of the certificate, the purchaser must first present the Department of Revenue with a written statement from the seller authorizing the release of the information. For an appointed representative to receive the certificate of clearance, a written document must be presented to the Department of Revenue, along with the business name and the sales and use tax permit number.
>
> The certificate of tax clearance states that the business applying for clearance had filed all sales and use tax returns though a particular period and that all applicable tax, interest and penalties computed thereon have been paid. It is in no way intended to release either the

purchaser or seller from any tax liability resulting from business operations or the sale of business assets after the issuance of the certificate.

Potential Liability (KRS 139.680)

When a purchaser fails to withhold an amount from the purchase price as required above, he becomes personally liable for the existing sales and use tax liabilities of his predecessor. (A contractual agreement between the two parties does not void the purchaser's liability).

This liability extends only to the purchase price amount, valued in money, which includes any debts assumed by the purchaser or any other valuable consideration.

After a sale has been consummated, the successor may contact the Department directly to receive a certificate of tax clearance on the predecessor's business.

The purchaser will be released from any further liability if the Department fails to respond to the written request within sixty (60) days of the receipt of the request or within sixty (60) days from the date the former owner's records are made available for audit. (The Department's response must be made within ninety (90) days of receipt if an audit is involved).

It is emphasized that **KRS 139.670** and **139.680** provide that the successor is personally and primarily liable for any sales and use tax liability due only in the event of failure to fulfill the requirements of these two statutes. In the event the successor becomes liable by failing to comply with the requirements of the statute, the successor alone should be billed.

This does not mean that the predecessor is no longer liable, but his liability is purely secondary. If difficulty is expected in the collection of the tax from the successor, it would be permissible to bill both. The successor being primarily liable, however, may not refrain from paying the bill on the theory that his predecessor might pay it. The Department must look to the successor for satisfaction of a tax liability.

A written request specifically asking for the release mentioned in **KRS 139.680** must be submitted by the successor before the ninety day time limit begins to run.

Invoking of Successor's Liability

It should be noted in passing that for "Successor's Liability" provisions to be invoked, there must be (1) a sale of a business or (2) sale of a stock of goods or otherwise quit the business.

The sale of business includes the sale of fixtures, equipment and other fixed assets as well as inventory items or stock of goods. Consider the following:

An oil company owns all of the equipment and fixtures and is leasing the station to an individual who in turn has purchased the oil company products for resale. The individual decides to sell the stock of goods and the oil company agrees to buy back the goods with the intent of operating the station. The original operator has failed to remit sales tax incurred on sales made for three months prior to the sale of the stock of goods to the oil company.

Under Successor's Liability, even though the oil company has repurchased their own goods for resale, the Successor's Liability is invoked and the oil company is responsible for tax liability on these sales.

It is recognized that under Successor's Liability the liability of the seller includes those liabilities incurred at the time of the sale, liabilities incurred prior to the sale, and to any liabilities that might be uncovered after the sale for periods prior to the sale. Procedure dictates that in a full-fledged audit situation, if the records are available, an audit will be requested on the previous account number and any liabilities incurred will be assessed against such account. However, if records are not available, only the sale/purchase of assets will be considered and any liability assessed against the new owner under Successor's Liability.

The aforementioned not withstanding, if the procedure is merely a review, only the sale/purchase of assets will be considered regardless of record availability.

Court Cases – Successor's Liability

Anson & Clark, Inc.

Sales tax was not paid on the sale of the business assets of Bottled Gas to Anson & Clark. Anson & Clark (purchaser) did not withhold **(KRS 139.670)** any portion of the purchase price to cover the sales tax liability. The seller, Bottled Gas, did not produce a receipt from the Cabinet showing that sales tax had been paid or a certificate stating that no amount was due.

Anson & Clark (purchaser) did not make a written request of the Cabinet for a certificate of no sales tax liability prior to paying over the purchase price to Bottled Gas.

Subsequent to the sale, on October 15, 1983 and after the audit by the Cabinet, Anson & Clark requested a receipt or certificate from Bottled Gas. However, Anson & Clark had not withheld any of the purchase price to cover the sale tax liability. Anson & Clark had not complied with **KRS 139.670/KRS 139.680.**

Super Quik, Inc.

The issue was whether Super Quik, Inc. was responsible for sales and use tax on the following two transactions:

- ♦ Whether Super Quik, Inc. **(seller)** was liable for sales tax on its sale of fixtures and equipment to Perry Drug Stores (purchaser); and
- ♦ Whether Super Quik, Inc. was liable for sales and use tax on its purchase of the assets of a Speedee Mart **(seller)** grocery store.

Super Quik, Inc. was a Kentucky domiciled corporation engaged in the business of retail food sales. On October 28, 1985 Super Quik sold a portion of its fixtures and equipment to Perry Drug Stores for $65,000. Super Quik did not collect nor remit sales tax on this transaction. As a part of this transaction, Super Quik obtained a tax clearance to Perry Drug thus the purchaser (Perry Drug) was relieved of any responsibility for the tax pursuant to **KRS 139.670.** On April 16, 1989, Super Quik purchased the fixtures and assets of a Speedee Mart store for $28,366. Super Quik, Inc. did not withhold from the purchase price nor did it obtain a tax clearance in accordance with **KRS 139.670.** Super Quik, Inc. maintained that both transactions should be exempt as occasional sales under the provisions of **KRS 139.470(4).** Also, that the taxes due on Super Quik's purchase should be assessed against the seller pursuant to a contract with the seller.

In that the successor (Perry Drug Stores) did comply with **KRS 139.670,** successor's liability was not applicable. However, this was a taxable sale, thus the seller (Super Quik, Inc.) was responsible. Successor's liability was applicable in the purchase applicable to Speedie Mart.

Triple R Food A Rama

The issue again was whether the purchaser of a business becomes personally liable for the sales tax liability of the predecessor.

In addition, whether the fact of purchasing the business under the installment method satisfies the requirement of **KRS 139.670** to withhold sufficient funds from which to pay the sales and use tax liability.

The taxpayers protested that portion of the sales and use tax assessment which was assessed prior to their ownership. The taxpayers contended that since they were making installment payments that they had "withheld" sufficient funds from which to pay the sales and use tax liability of their predecessors; therefore they had complied with the statute. They also argued that the Cabinet must first proceed against the predecessors before assessing them for the sales and use tax liability.

The Cabinet contended that the purchaser of a business or stock of goods is protected only by withholding from the purchase price an amount sufficient to cover the tax deficiency until the seller produces either a receipt from the Cabinet showing that the taxes have been paid or a certificate indicating that no tax is due. Failure to withhold subjects the purchaser to personal liability. The Cabinet contended that the taxpayers did not withhold any funds to cover the sales and use tax liability; therefore they were personally liable.

The Kentucky Board of Tax Appeals affirmed the Cabinet's assessment and determined that the taxpayers were liable as successors-in-interest for the sales and use tax liabilities of their predecessors. The taxpayers appealed the Board's decision to the Leslie Circuit Court. This court reversed the Board's decision and held that the taxpayers did withhold funds to cover the sales and use tax assessment of their predecessors and that the Cabinet must proceed against the former owner and then execute upon the funds withheld by the purchasers.

Summary of Decision

The Court of Appeals reversed the Leslie Circuit Court's decision and affirmed the Board's decision. The Court of Appeals held that it was of no consequence that the taxpayers owed a sufficient balance on the purchase price which may be seized by the Cabinet in proceedings against the delinquent sellers. In discussing the successor liability statutes, the court held that the public interest in collecting taxes demands that tax liability follows the assets of a business. Therefore, a clear and proper interpretation of the successor liability taxing scheme is to impose liability upon any purchaser who has purchased the assets of a business in disregard of the statutory obligation. It seems not unreasonable that a purchaser who succeeds to ownership and possible liquidation of business assets first require the former owner to produce evidence of tax satisfaction in the form of a payment receipt or certificate of no taxes due from the Cabinet, or incur the risk of personal liability for any unpaid tax debt to the extent of the purchase price.

The Kentucky Supreme, on 2/8/95, denied the taxpayers' Motion for Review. The taxpayers' chose not to proceed further; therefore the Court of Appeals decision became final.

The Court of Appeals' decision affirms the Cabinet's long-standing interpretation of the successor liability statutes. Thus, no change in Cabinet policy.

Columbia Steak House Systems, Inc.

Purchasers of a retail business will be liable for existing sales and use tax only if the sale is a total liquidation of the assets of a business. If operators of several retail businesses at different locations sell the entire assets of one business location the purchaser would be liable for the tax on the purchase price of the tangible personal property (except inventory) purchased in association with the purchase of the business.

Part of the use tax due in this case resulted from the purchase of a restaurant from Jerrico, Inc. If the transaction represents only a partial sale of assets, no sales tax liability may be passed on to the purchaser, provided the seller remains in business. Multiple purchasers of an entire stock of business assets may be held jointly and severally liable for the total sales and use tax liability.

AUDIT PROCEDURE

General Procedure for Evaluation of Validity of Occasional Sale Deduction

When evaluating a transaction to determine the validity of an occasional sale deduction, it is most economical to evaluate the 3 qualifying conditions in the following order:

First evaluate the transaction for the previously discussed requirement #3, the real or ultimate ownership test. If the real or ultimate ownership of the assets has not changed, then nothing in the transaction is taxable and no additional criteria have to be evaluated.

Next evaluate the sale to determine if the any of the assets sold are of a type which would subject them to tax. Sales of realty and intangibles are not tangible personal property and would not be taxable regardless of the other conditions of the sale. Stocks of inventory normally held in the sellers business for resale would not be taxable when sold. If an entire business is sold, it is normal procedure to obtain a copy of the sales agreement to determine the part of the selling price assigned to the various types of assets sold. It is also normal audit procedure to view a corporation's Federal Form 4797 to determine the taxability of sales of assets used in the business when the entire business is not sold.

Next evaluate the business of the seller and the transaction (requirement #1) to determine the classification of the sold assets. If some of the assets are determined to be selling assets and no other exemption applies, such as the enterprise zone, then the selling assets of the transaction are taxable. They are taxable regardless of the number of sales of similar assets, the character of the assets, and scope of the sale. These considerations do not enter into the sale of selling assets even if the transaction consists of the sale of the entire business.

If the seller has no selling assets you would next evaluate requirement #2 to determine if the taxpayer has become a retailer of these type assets by making a series of sales of assets of similar size, scope and character. Traditionally, three such sales in any 12 month period has been determined to make the taxpayer a retailer of those assets ,hence they are taxable if no other exemptions are applicable.

<u>Sale of Entire Business/Stock of Goods</u>

If the seller is under audit, assess the seller for the sale of the business.

If the purchaser is under audit, assess the purchaser. It is the responsibility of the taxpayer under audit to show that the tax has been paid.

If a taxpayer under audit has both purchased and sold the business, assess the tax only once on the taxpayer as the purchaser.

<u>Statute of Limitations</u>

KRS 139.680(3) states that "The time within which the obligation of a successor may be enforced shall start to run at the time the retailer sells out his business or stock of goods or at the time that the determination against the retailer becomes final, whichever event occurs the later."

In other words, the tax clearance is only to be issued prior to the sale of the business. It cannot be issued after the fact. Therefore, if no tax clearance is requested before the sale, then the determination of liability on the seller does not refer to the tax clearance certificate. "The time that the determination against the retailer becomes final" may indeed refer to the findings of an audit. If periods were open on a seller because of a failure to file, then the successor could be held liable for those periods even if they were outside the normal four-year statute.