Memorandum

To: Marysville – Compliance (RFD)  Date: Sept 4, 1964

From: Legal Counsel (JHK)

Subject: “W” and “A”

This is a reply to your letter of August 26, 1964 concerning the transaction between “W” and “A”. It is our understanding “W” sold his business to “A” for $32,000 of which $3,000 represented retail sales of tangible personal property. “A” made three payments of $550 but was unable to make the fourth payment. “A” and “W” agreed to return the business to “W” and cancel the contract of sale. You ask whether a rescission has taken place or whether the agreement to cancel constituted a second sale also subject to tax.

While the above facts are incomplete, we believe from what you have said a rescission has occurred. Civil Code Section 1689 lists as a ground upon which rescission may be based that a party to a contract may rescind it “by consent of all the other parties.” In the present case, the parties agreed to end the contract and return the business to “W”. We believe this to be a rescission by mutual consent within the meaning of Civil Code Section 1689.

The fact that “W” did not return the three payments does not defeat the rescission. In order to maintain rescission the parties must be returned to the status quo. However, the courts have interpreted this to mean that the parties are required to return only what was transferred under the contract over and above the benefits conferred by the contract (Hill v. Craft (1955), 133 Cal. App. 2d 506 [284 P.2d 832]. Accordingly, the payments made under the contract could have been considered as payment for the benefit of using the business and deriving profits from the business during the period when “A” was in possession.

Sales tax applies to the transfer from “W” to “A” because there was a sale under the sales tax law where the business was transferred although title may have been retained in escrow as security. A returned merchandise deduction is not allowable because the full purchase price was not refunded. However, the contract of rescission does not constitute a second sale under past interpretations. Accordingly, tax does not apply to it.

JHK:mm [1b]