

12/29/99

CFS HEALTH GROUP, INC.	*	No. C-95-0014-02
COLUMBIA/FREE STATE MANAGEMENT, INC.		No. C-95-0015-02
FREE STATE MANAGEMENT CORPORATION	*	No. C-95-0016-02
FREE STATE HEALTH PLAN, INC.		No. C-95-0017-02

vs.

COMPTROLLER OF THE TREASURY
COMPLIANCE DIVISION

IN THE
MARYLAND TAX COURT

MEMORANDUM OF GROUNDS FOR DECISION

Petitioners are four subsidiaries of Blue Cross Blue Shield of Maryland, Incorporated ("BCBS"). Two of the Petitioners, Free State Management Corporation ("FSMC") and Columbia Free State Management, Inc. ("CFMI"), transferred their capital assets to Free State Health Plan, Inc. ("FSHP") in 1991. Thereafter, both corporations filed articles of dissolution with the Department of Assessments and Taxation on April 29, 1994. This was prior to the assessments that were levied on June 23, 1994. In 1992 FSHP transferred its assets to CFS Health Group, Inc. ("CFS"). It should be noted that BCBS is engaged in the business of providing health care service and is also a third party insurer paying health care benefits on behalf of its members. FSMC and CFMI were wholly owned by BCBS through another wholly owned entity, Community Health Services, Inc. ("CHS"). CFMI was engaged in providing management services for the other members of BCBS companies, including FSHP and CHS.

In 1991, CFMI and FSMC ceased all of their regular business operations after the transfer of all of their assets to FSHP. CFMI adopted its final plan of liquidation and dissolved as a corporate entity on April 29, 1994; and FSMC adopted its final plan of liquidation on March 18, 1994 and was also dissolved as a corporate entity on April 29, 1994. At that time, both companies received tax clearance certificates from the Comptroller in March and April of 1994 certifying that no taxes were owed to any governmental agency.

The inter-relationship between all four of the Petitioners surrounding the tax assessed against FSHP and CFS, resulting from the CFMI and FSMC distributions, is important in determining the sales tax liability assessed against Petitioners CFMI and FSMC. In 1993, BCBS was advised by the Comptroller that ten of BCBS's subsidiary companies were to become the subject of a sales and use tax examination. Final assessments were issued virtually simultaneously against all four Petitioners with FSHP contesting \$143,453.68 (plus interest and penalty) of the original assessment and CFS protesting \$98,851.08 (plus interest and penalty). FSMC and CFMI also protested the assessments against each entity in the amount of \$40,867.47 (plus interest and penalty) against FSMC and \$142,375.20 (plus interest and penalty) against CFMI. The Petitioners request that all the assessments be abated.

There are a number of legal questions presented to the Court for determination. The first issue introduced is whether the distribution of property, from CFMI and FSMC to FSHP in 1991 and from FSHP to CFS in 1992, is subject to sales tax. In other words, do Petitioners' transfers qualify as exempt liquidating distributions under

Section 11-209(b) of the Tax-General Article of the Annotated Code of Maryland. The second issue is whether the Comptroller is estopped from asserting that the tax is due because of the issuance of tax clearance certificates. The final issue is whether the transfers should be exempt from sales and use tax because they were part of a corporate liquidation ordered by the Maryland Insurance Commissioner in 1991.

As for the first issue, the Petitioners claim that the aforesaid transfer of assets were liquidating transfers and that CFMI and FSMC ceased operations and never resumed doing business in 1991. The Petitioners contend that the assets were distributed in liquidation to FSHP, as the nominee of CHS, and BCBS in the latter part of 1991 and later to CFS in 1992. However, the Comptroller contends that the assets must be distributed to the shareholders of CFMI and FSMC, and that a nominee cannot receive liquidating distributions from a corporation and avoid tax on the aforesaid transfers.

The Court agrees with the Comptroller that the asset transfers are not exempt under Section 11-209(b) of the Tax-General Article of the Annotated Code of Maryland. Tax-General Article, Section 11-209(b)(1) provides that “the sales and use tax does not apply to a distribution of tangible personal property by a corporation . . . to its stockholders as a liquidating distribution.” Neither the 1991 nor the 1992 asset transfers at issue qualifies for the liquidating distribution exemption for the following reasons: (1) the assets were not distributed to the sole stockholder of FSMC and CFMI and (2) consideration was paid in return for the assets, other than the surrendered stock of CHS. In addition to the reasons aforementioned, the 1992 asset transfers do not qualify because (1) consideration

was paid in return for the assets, other than the surrendered stock and (2) Free State continued to exist after the transfer.

The evidence indicates that assets were not distributed to the sole stockholder of FSMC and CFMI. The evidence also indicates that CHS was the sole stockholder of both FSMC and CFMI in 1991. But there was no transfer of the assets of FSMC and CFMI to CHS. Instead, the assets were transferred in 1991 to Free State, a sister subsidiary of CHS and the Free State's parents, CFS Health Group. The Court will not ignore the statutory requirement that a liquidating distribution must be made to the stockholders of the liquidating corporation. The individual corporate entity of the subsidiary cannot be disregarded merely because the parent corporation owns the subsidiary or because one person holds all of the stock. Quinn vs. Quinn, 11 Md. App. 638, 648 (1971). The Court agrees with the Comptroller that transfers of property between related corporations are subject to taxation, in the absence of a specific exemption from tax. Section 11-209(b)(1) is clear and unambiguous and therefore the exemption does not apply to the 1991 and 1992 asset transfers.

Secondly, consideration was paid in return for the assets, other than the surrendered stock of CHS. The evidence is clear that the consideration for all the asset transfers was a release of corporate debt owed by the transferors to the transferees. There was no mere surrender of stock for assets in 1991 and 1992. Debt forgiveness constitutes consideration for tax purposes. In addition, no evidence has been offered which shows that the transactions would qualify as liquidating distributions under the Internal Revenue Code. Section 332 of the Internal Revenue Code has no application to

the present sales tax case. The form of these transactions as structured by the taxpayers require this Court to find that the transactions are taxable sales and not exempt liquidating transactions.

As for the second issue, the Petitioner asserts that the Comptroller is estopped from asserting that the tax is due because of the issuance of tax clearance certificates. However, the evidence suggests that the taxpayers never filed any sales and use tax returns, and that the Comptroller's records could not and did not show any tax liability until the assessments were levied on June 30, 1994. Section 13-806(a) of the Tax-General Article provides that the lien for unpaid sales taxes "arises on the date of notice that the tax is due." Evidence demonstrates that the date of notice was June 30, 1994. The certificates were accurate in stating that no tax was due on the dates the certificates were issued in Maryland and April of 1994. However, the certificates do not indicate that an assessment would be levied after the issuance of the certificates for tax that was unpaid and unreported on the dates the certificates were issued.

The Petitioners reliance on Crown, Pipe and Foundry vs. Davis, 167 N.E. 2nd 390 (OH. Com.Pl., 1960) is without merit. In the Ohio case, the taxing authorities mistakenly issued personal property tax clearance certificates. Although the corporate predecessor in interest had filed returns showing tax was due; in the present case, the taxpayers never filed any sales and use tax returns, the Comptroller could not and did not show any tax liability at the time the certificates were issued.

The Petitioners contend that the auditor should have informed the Accounting Division of the audit. The Court disagrees. In a letter dated December 17, 1993, Mr. Gary

C. Baker, BCBS Director of Corporate Audit, did not inform the auditors that FSMC and CFMI were planning to dissolve. Mr. Baker knew that the Comptroller and BCBS had agreed that BCBS would assume the sales and use tax liability for all subsidiaries that would dissolve prior to the completion of the audit. Consequently, FSMC and CFMI knew or should have known that the tax clearance certificates do not apply to any tax that would have been found due as a result of the audit.

Thirdly, the Petitioners contend that the transfers should be exempt from sales and use tax because they were part of a corporate liquidation that was ordered by the Maryland Insurance Commissioners in 1991. It is well settled that tax exemption statutes are to be strictly construed in favor of the State and that to doubt an exemption is to deny it. It is clear that neither the 1991 nor the 1992 asset transfers are exempt from sales and use tax under Section 11-209(b)(1). Although the Insurance Commissioner did order FSMC and CFMI to dissolve, the Commissioner's order did not suggest that Petitioners transfer the assets. The Petitioners could have structured the dissolution in any fashion they chose. Each asset transfer was simply a transaction for consideration, other than the surrender of stock of the corporation, and therefore a "sale" under Tax-General Article, Section 11-101(g)(1). The assessments against the operating companies must be affirmed.

With respect to the assessments against the management companies, FSMC and CFMI, Petitioners suggest that the assessments are invalid since the corporations were dissolved while the audit was in progress. It is well settled that a corporation cannot escape liability for a tax assessment by simply dissolving prior to the issuance of the

assessment. Consequently, the Petitioners should not have reasonably believed that the issuance of tax clearance certificates invalidate otherwise proper assessments. Under Maryland corporate law, corporations are managed under direction of a Board of Directors and therefore the Directors and consequently the Corporations could not have reasonably relied on the issuance of the tax clearance certificates. Respondent's Exhibit No. 9 clearly suggests that the Petitioner, through their Directors, knew that the limitations period for sales and use tax audits of FSMC and CFMI had extended to June 30, 1994, and that those subsidiaries would probably be dissolved prior to that date. In addition, BCBS knew or should have known that the Comptroller wanted BCBS to assume the sales and use tax liability for any subsidiary that would be dissolved.

Therefore, this Court affirms the assessments levied against Free State Health Plan and CFS Health Group, as well as Free State Management Company and Columbia/Free State Management, Inc.