

January 14, 1972

Gentlemen:

This is to inform you of our position with respect to the petition for redetermination of the tax filed on November 16, 1971, by _____ on behalf of _____. It will be our recommendation to the board that the petition be denied.

We understand that tax has been assessed with respect to the transfer of certain capital equipment from _____ to _____. Both _____ and _____ have been wholly owned subsidiaries of _____ Corporation.

_____ was authorized to commence business in California on December 19, 1968. _____'s principal business purpose was to operate a chain of fast food restaurants, trading under the name "_____." The corporation was not successful and through July 31, 1970, sustained losses of approximately \$84,000. It was decided that to avoid further loss, the existing restaurants should be converted into _____ and that those _____ which could not be converted be closed.

It was also decided to merge _____ into _____ at a convenient date in fiscal 1971. An intra-corporate memorandum dated December 4, 1970, apparently recording the operational decision to carry out this merger "on the last day of fiscal 1971" is enclosed with your petition. As of December 20, 1970, _____ owned \$630,000.

4 Commencing on December 20, 1970, various properties were transferred from _____ to _____ for use in the converted units and other locations. These transfers were made on December 20, 1970, February 14, 1971, April 11, 1971, May 9, 1971, and July 4, 1971.

On or about July 3, 1971, _____ transferred its capital stock in _____ to _____. In anticipation of this transfer, on June 23, 1971, the directors of _____ authorized the merger of _____ into _____ and directed the "proper officers" of _____ "to do all acts and things whatsoever ... necessary or proper to effect said merger." It appears the merger was legally effected on August 1, 1971.

You have taken the position that the five transfers regarded as taxable are only steps in the tax-free liquidation of _____, that no taxable transactions or sales of assets took place between the subsidiary corporations and that all transactions were made only as a general plan of reorganization and do not bring about a taxable event.

You further contend that the sales recorded as taxable are exempt under sections 6006.5 and 6367 of the Revenue and Taxation Code, and that the transfers were not for value, were not sales, or were "forced transfers more akin to the taking of title to assets by a creditor to satisfy an indebtedness."

We are of the opinion that the tax has been properly asserted in this case. Although _____ and _____ are related corporations and it was contemplated that _____ would be liquidated into _____, we see no basis for recommending any adjustment in the determination. The California Sales and Use Tax Law provides that tax applies to the retail sale of tangible personal property in this state [Rev. & Tax. Code Sec. 6051]. The sales in question would have been no more nor no less taxable if _____ had subsequently abandoned its plan to cause the merger of _____ into _____. While it is certainly true that tax could have been avoided if _____ had sold, in a single sale, all of its assets to _____, or if title to _____'s assets had passed to _____ by operation of law as a result of a statutory merger, neither of those courses of action were followed by the parties.

The sales in question are not exempt under section 6006.5 and section 6367 of the Revenue and Taxation Code because (1) the property transferred was held or used in the course of an activity requiring the holding of a seller's permit, and (2) the transfers were not, individually, transfers of all or substantially all the property held or used by _____ in its permit requiring activities.

The transactions appear clearly to be "sale" transactions, and the transfers would be for "value," even if _____ merely cancelled a portion of _____'s outstanding indebtedness in exchange for the assets. Cancellation of indebtedness is sufficient consideration to support the transfers as sales transactions. Finally, it is immaterial that _____ may have been in the position of a "threatened" debtor of _____. The transfers were entirely voluntary. Even if _____ seized the assets of _____ pursuant to the default provisions of a general financing agreement, tax would be applicable on the sale of the assets in satisfaction of outstanding obligations.

Our recommendation will be presented to the board for its consideration in due course. You have not requested to appear before the board; but if you should desire to do so, you should make your request known to Mr. James L. Martin, Petitions Unit, State Board of Equalization, Box 1799, Sacramento, California 95808, within thirty days of the date of this letter.

Very truly yours,

Gary J. Jugum
Tax Counsel

CJJ/ab

bc: – District Administrator