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June 30, 1995

VIA FACSIMILE AND U.S. MAIL

Mr. P--- J. S---
O---, H--- & S---
XXX --- Street
--- ---, CA XXXXX-XXXX

Re: V--- A---, Inc.
SY - XX-XXXXXX

Dear Mr. S---:

This is in response to your May 11, 199X letter to Assistant Chief Counsel Gary Jugum regarding the application of tax on various transactions involving the transfer of corporate stock and the liquidation of a corporate subsidiary.

You state:

"V--- A---, Inc. ('V---') will enter into a stock sale agreement with an entity to be identified (the 'Buyer'). The Buyer is interested in purchasing a core business of V--- that develops, manufacturers, and distributes microwave tubes, power grid tubes, microwave amplifiers, modulators, and various other power supply equipment (the 'E--- D--- B---'). To facilitate such sale, V--- will contribute the assets and property of the E--- D--- B--- to its newly formed subsidiary ('EDB S---') in exchange for the first issuance of EDB S--- stock. EDB S--- will not assume any liabilities of V---. The Buyer will then purchase the EDB S--- stock from V---."

You further state that the foregoing transaction is structured as a stock sale in order to preserve V---'s rights to transfer its interest in various real property leases that it currently maintains with L--- S--- J--- U--- ("S---"). Once the proposed transaction takes place, V--- will request S--- to execute a lessor's estoppel certificate. Should S--- refuse, the transaction will nonetheless proceed as described above.

You request our opinion as to the application of tax on a series of separate transactions involving V---, EDB S---, and the Buyer. Before responding to these requests, however, we note that tangible personal property is ultimately being transferred from V--- to the Buyer by way of multiple transactions between the several parties. These types of transactions require a two-tier analysis. First, each step in the series of transactions must be analyzed for the purpose of ascertaining if there is a taxable transaction between two parties. Second, the transactions must be collectively analyzed for the purpose of determining whether, under the California Sales and Use Tax Law, the intervening steps of the transaction should be disregarded and the transactions should be analyzed only on a before and after basis, with all intervening steps of the transaction disregarded for sales and use tax purposes. In particular, under the facts presented here, the individual series of transactions between the parties will be disregarded if they are undertaken for the purpose of avoiding or altering the California sales or use tax liabilities of the parties. With that in mind, I will first discuss whether tax applies to each of the individual transactions between the parties.

A. Individual Transactions

"(1) No California sales or use tax will [be] [sic] owed by V--- or EDB S--- upon the contribution by V--- of the E--- D--- B--- to EDB S--- in exchange for EDB S--- stock."

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.)

Title 18, California Code of Regulations (hereafter "Regulation"), section 1595(b)(4) specifies that tax does not apply to a transfer of property to a commencing entity (e.g., a corporation or partnership) in exchange solely for an interest in that commencing entity. (See also Business Taxes Law Guide Annot. 395.1800 (1/7/53).) This provision is not, however, an exemption from tax. Instead, a transaction which meets the requirements of Regulation 1595(b)(4) is not regarded as a taxable sale or purchase of tangible personal property. On the other hand, that provision explains that where a transferor receives consideration such as cash, notes, or an assumption of indebtedness in addition to an interest in a commencing entity, that transfer constitutes a sale which is subject to tax unless it otherwise qualifies for an exemption. (Beatrice Co. v. State Bd. of Equalization (1993) 6 Cal.4th 767.)

In this case, V--- will transfer assets from its E--- D--- B--- to a newly formed EDB S--- in exchange for the first issuance of EDB S--- stock. You state that the EDB S--- will not

assume any liabilities of V---. We also assume that V--- will not receive any cash, notes, or other consideration for its transfer of assets to the EDB S---. Thus, in examining this step of the transaction only, V---'s transfer of assets to the EDB S--- solely in exchange for EDB stock will not constitute a taxable sale or purchase of tangible personal property.

"(2) No California sales or use tax will be owed by V--- or the Buyer upon the sale by V--- of the EDB S--- stock to Buyer."

Stock is not regarded as tangible personal property for purposes of the Sales and Use Tax Law. (Business Taxes Law Guide Annots. 395.1250 (5/8/87), 395.1570 (8/9/93).) This means that the sale of stock is not subject to sales or use tax. Thus, in examining this step of the transaction only, no sales or use tax will apply with respect to V---'s sale of its EDB S--- stock to the Buyer provided this sale consists only of the EDB S--- stock and no other tangible personal property.

"(3) No California sales or use tax will be owed by V---, EDB S--- or the Buyer upon any liquidation of EDB S---."

When an entity distributes its assets as a complete liquidation ratably to its owners (i.e., a distribution of assets to partners or shareholders in the same percentage as their ownership interests in the entity), the transfer will not be taxable unless consideration is received for the transfer. (See, e.g., Business Taxes Law Guide Annots. 396.2280 (1/3/93), 395.2260 (10/5/56), 395.2340 (5/7/56).) That is, the liquidation of a corporation's assets is not taxable if the only item received by the transferor corporation is the return of the interest in the entity, i.e., stock, for the purpose of cancellation and there is no other consideration such as an assumption of liabilities.

You state that the Buyer may liquidate the EDB S--- and operate the E--- D--- B--- as a division or separate business. If a liquidation occurs, tax applies on the transfer of the EDB S---'s assets to the Buyer where the Buyer provides some form of consideration for the transfer (e.g., cash, notes, an assumption of indebtedness) plus the return of the stock for cancellation.^{1/} In examining this step of the transaction only, however, the transfer of EDB S---'s assets to the Buyer pursuant to a complete liquidation is a non-taxable transaction provided the Buyer transfers only the EDB S--- stock (and no other consideration) for cancellation.

B. Collective Transaction

The foregoing series of transactions between the parties will be disregarded if they are

^{1/} Under this scenario, we assume that the EDB S--- would be registered as a retailer and hold a California seller's permit such that a transfer of its assets to the Buyer in this situation (i.e., a transfer of assets for consideration plus the cancellation of stock) would not qualify as an exempt occasional sale. (See Rev. & Tax. Code §§ 6367, 6006.5(a); Reg. 1595.)

undertaken for the purpose of avoiding or altering the California sales or use tax liabilities of the parties. That is, where there is no valid business purpose for structuring a series of transactions to achieve the ultimate transfer of property from V--- to the Buyer other than for the avoidance of California sales or use tax, the series of transactions will be disregarded and the transaction will be viewed as a taxable sale of tangible personal property from V--- to the Buyer.

You state that the transaction is structured as you describe so the Buyer will be permitted to benefit from several favorable leases of real property by S--- to V--- without the need to obtain S---'s consent. In particular, you state that it is V---'s belief that its leases with S--- permit it to transfer property subject to these leases to a wholly owned subsidiary and then sell the stock of that subsidiary without obtaining S---'s consent. We note, however, that this transaction will proceed as you describe whether or not S--- provides the Buyer with a lessor's estoppel certificate. This raises the question of whether the transaction is actually structured in this manner in order to avoid sales tax. That is, our understanding is that the parties will enter into the transaction as proposed whether or not the business purpose will be obtained. If such is the case, we would regard the transaction as structured in this manner to avoid sales tax, and would treat the transaction as a taxable sale from V--- to the Buyer.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:cl

cc: --- --- District Administrator