

December 23, 1959

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Attention: Mr. ---

Gentlemen:

Your letter of December 17 requested a ruling on the following factual situation.

Party "A" is to contribute to a new corporation all of the assets and liabilities of his sole-proprietor retail business. Party "B" is to contribute notes and accounts payable due him by party "A". In exchange for these contributions, each party shall receive 200 shares of \$50.00 par value capital stock and five \$2,000.00 notes due at variable times.

It is our opinion that the transfer by "A" does not qualify as an exempt occasional sale under part (b) of Section 6006.5 of the Sales and Use Tax Law, pamphlet copy enclosed. In arriving at this conclusion, we presume that "A" and "B" will be the sole shareholders in the new corporation. If this is the case, "A's" former ownership interest of 100% in the tangible personal property transferred to the corporation will be reduced to a 50% interest.

The question of whether the notes to be issued constitute "bonds" or "an interest in the corporation" as mentioned in Section 6006.5 might be important under different factual situations. Here, however, the answer to this question is of no assistance in determining if the occasional sale exemption applies since, even if they do represent an ownership interest, a substantial change in ownership will occur as stated above.

For your general information, it is our opinion that the reference to bonds in the occasional sale exemption means bonds of the type which will be an ownership interest in a corporation rather than merely a creditor-debtor relationship. In order that any security qualify as a bond for sales tax purposes it must be issued in serial form with interest coupons attached, payable at a date certain, registerable, readily transferable, convertible to stock if desired, and kept in provisions which provide for acceleration of payment in case of default. A "bond" which does not under its own term create a lien against corporate property superior to prior and subsequent creditor's claims would probably be considered debentures similar to notes ordinarily issued general creditors.

Even though the occasional sale exemption is not applicable, we believe that "A's" transfer is only partially taxable. As you are probably aware, there is an administrative exemption for property contributed to a commencing entity solely in exchange for an ownership interest therein. However, any consideration tendered the transferor of the property except an ownership interest therein will constitute the measure of his sales tax liability. Being that the notes tendered by the corporation do not

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represent an ownership interest in the corporation, we believe that your client's tax liability should be computed by use of the following formula:

$$\frac{\text{Consideration other than shares}}{\text{Total consideration}} \times \text{the sales price of taxable assets} = \text{taxable measure.}$$

The above remarks would apply even if "A" and "B" were to receive corporate stock instead of serial notes. However, the measure of "A's" tax liability would be reduced since the \$10,000.00 notes would then be converted to an additional \$10,000.00 in stock and would not be included in computing the taxable measure. The result would be that only the liabilities assumed by the corporation would be included in the above-mentioned formula.

We trust that this answers your question. If we have misinterpreted your situation or can be of any additional service, please so inform us.

Very truly yours,

J. J. Delaney  
Associate Tax Counsel