

December 17, 1957

Gentlemen:

In your letter of December 5 you requested information concerning the application of the California sales tax to the transfer by a partnership of some of its assets to a newly-formed corporation. You stated that following the transfer the partnership would still be in possession of a substantial amount of partnership assets.

Sales and Use Tax Ruling 81, which is the administrative interpretation of Sections 6006.5 and 6367 of the Sales and Use Tax Law, provides that tax does not apply to transfers of all or substantially all the property held or used in the course of an activity for which a seller's permit is required provided that after the transfer the real or ultimate ownership of the property is substantially unchanged. We have interpreted the word "substantial" to mean a transfer of at least 80 percent of the assets so held or used. If at least 80 percent of the assets are transferred, the occasional sale exemption would be complied with and the transfer you suggest would be entirely free from sales tax.

In some instances, transfers of less than 80 percent of total assets will qualify as ~~not taxable~~ if said transfers are to a commencing corporation solely in exchange for a percentage of ownership in that corporation. This is not the occasional sale exemption, but is based on the theory that the stocks received do not amount to taxable consideration. If there is additional consideration tendered by the corporation, such as notes, cash, or assumption of liabilities, we believe that more than an interest in ~~the~~ business ^{is} being transferred and that to this extent, taxable gross receipts do exist. Therefore, if the transfer by the partnership does not qualify as an occasional sale, it would ~~be taxable~~ ^{not be taxable} except to the extent that the commencing corporation assumed partnership liabilities (\$75,000). that does not yet have value

We cannot answer your question concerning debentures without knowing the exact terms and scope of the certificate you have in mind. Because of the somewhat loose use of the term "debentures", we cannot be sure that you are referring to instruments which would make the partners owners of the corporation rather than general creditors. You will notice that the

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last sentence of part B of Section 6006.5 of the law provides that stockholders, bondholders, etc., are regarded as having the real or ultimate ownership of the property of the particular entity involved. If the debentures are so constituted that they qualify as bonds representing a share of ownership in the corporation, we believe that they would not amount to a taxable consideration.

We believe that your contention that the assumption by the corporation of the \$75,000 debt should not make the transfer taxable, is based on the erroneous assumption that a change in ownership has not occurred. Unless the requirements of the occasional sale exemption are met, it is our opinion that a transfer of property has occurred between two different identities, namely, the partnership and the corporation, for a consideration. Such a transfer falls within the definition of a sale.

Very truly yours

J. J. Delaney
Assistant Counsel

JJD:tl