State of California **Board of Equalization**

M e m o r a n d u m

395.1880

To: Mr. J. D. Dotson Date: June 5, 1970

From: Lawrence A. Augusta

You requested that I review the petition for redetermination of "S" prior to your trip to the East. Mr. "B" of "S" tax department, in writing the petition, requested an informal hearing with a hearing officer at our Chicago district office. You propose to hold that hearing along with representatives of our Chicago office during your trip.

It is my recommenation that the petition be denied. It seems to me, as I will explain hereinafter, that the issues are clear-cut and that there is no dispute as to the facts. I understand it to be the legal staff's policy that once one member of the legal staff has rendered an opinion on a particular matter, a legal staff hearing officer will not reverse that opinion unless it is clearly erroneous. Consequently, I would say that the next step for "S" after your hearing in Chicago, if they still disagree, is to appear at a Board Hearing.

I am stating my opinion in a memo to you rather than a letter to the taxpayer, as would normally be done, because of your scheduled meeting with the taxpayer.

As I understand the facts, "S" for some years had been engaged in the production and sale of agricultural chemicals through their "C" Division. In 1968, the "C" Division was renamed the "SA" Company, and in late 1968, the "SA" was organized as a Delaware corporation. By resolution of the board of Directors of "S", all of the assets of the "SA" were transferred to the new corporation pursuant to a bill of sale. The new corporations transferred to "S" all of their authorized capital stock, and the new corporation assumed the liabilities of "S" identified with the agricultural chemicals division. A determination was issued assessing tax on the ratable portion of California assets based on the amount of the liabilities assumed.

Mr. "B" cites Section 6006.5(b) relating to occasional sales; Regulation 1595(b)(3) relating to statutory mergers and consolidations; and Regulation 1595(b)(4) relating to contributions to commencing corporations, and argues that since no tax would be due on an assumption of liabilities in connection with a statutory merger, no tax should be due when an existing corporation incorporates one of its divisions. Referring to Section 6006.5, he argues this should be the result because the ultimate responsibility for payment of the liabilities is unchanged since all the stock of the new corporation is owned by the parent corporation.

First, the transfer is not an occasional sale because Section 6006.5(b) defines such a sale as including only transfers of all or substantially all of the property held by a person. To be an occasional sale, all of the property of "S", the parent, would have to be transferred to the subsidiary.

Further, our position that transfers to a commencing corporation in exchange solely for stock of the new corporation is not based on the theory that it is an occasional sale as "B" assumes. Rather, it is based on the theory that though there is a sale, there is no measurable valuable consideration received since the value of the stock is an arbitrary value placed on it by the incorporators. If the stock is traded on the exchange, as is the case with an existing corporation, there is measurable consideration. Likewise, when liabilities of the old corporation are assumed by the new corporation, there is measurable consideration.

Despite the fact that the two "S" corporations are related, and the stockholders of "S" are the real and ultimate owners of "SA" the fact remains they are separate corporations and separate "persons" under the law. In fact, the separate entity is the essence of creating a corporation. Since "S" would undoubtedly assert the entity when it is to their benefit, we will not allow them to deny it here.

It is true that no tax liability would arise were this a statutory merger or consideration; however, the fact remains that it is not a statutory merger or consolidation. In point of fact, it seems quite the opposite of a merger as it is a division of an existing corporation.

In a statutory merger, one or more corporations combine into a singe corporation, which may have a new name or carry on the name of one of the pre-existing corporations. The new corporation assumes the liablities of the old corporations. Here we had a single corporation and now have two corporations. The old corporation transferred some of its assets to the new corporation. This transfer was a sale, and the consideration received was the first issues of stock and the assumption of liabilities of "SA". While these are related companies, they are nevertheless separate and distinct corporate entities. While the real or ultimate liability is that of "S" shareholders, that is immaterial under the Sales and Use Tax Law, except where there is an occasional sale as defined under Section 6006.5(b).

As a general proposition, the fact that a taxpayer may avoid tax by arranging his affairs in a certain manner, as, for example, by choosing to follow the statutory merger scheme, has no bearing on the application of tax if he does not so arrange his affairs.

We have consistently held transactions, such as the one involved here, to be subject to tax.

LAA:ph [1b]