

**STATE BOARD OF EQUALIZATION**

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June 4, 1990

D--- S. B---, Esq.
J---, D---, R--- & P---
XXX S. --- Avenue, Suite XXXX
--- ---, CA XXXXX

Re: G. W. B---, Inc., Sales Tax Opinion

Dear Mr. Boyce:

In your June 1, 1990 letter to me, you request a ruling from the Board's legal staff concerning the application of the California sales and use tax to the proposed transfer of the hinge manufacturing business of G. W. B---, Inc., ("B---") to a newly-created subsidiary and subsequent sale of the stock of such subsidiary to an unrelated party based on facts described in your letter and as set forth below.

FACTS

B--- is the world's largest manufacturer of precision aircraft and aerospace hinges. B---'s customers include all major airframe and many component manufacturers throughout the world. Virtually all acquisitions of hinges from B--- are purchases for resale, and, consequently, are not subject to sales tax. Approximately eighty percent of its sales are for commercial aircraft and twenty percent are for military-related aircraft. In addition to its hinge manufacturing business, B--- is a real estate developer and investor.

B--- is located in ---, California in a manufacturing plant which houses its inventory, machinery, equipment, and tooling. B--- has a seller's permit with respect to its hinge manufacturing business.

B--- has recently entered negotiations with K--- Industries Inc. ("K---") with respect to the sale of its hinge manufacturing business (other than related real property, which will be leased to K--- for \$16.5 million. The sale is scheduled to occur by the end of July 19XX, but is contingent upon the outcome of due diligence and other work to be done by K---. It is expected that the contingencies will not be removed until very shortly before closing. Pending the removal of contingencies, B--- has chosen not to notify any of its employees of the possible sale. B---'s decision not to notify its employees is based on the business judgment that there is substantial possibility that the sale will not be consummated and that a notice of the proposed sale would unnecessarily disrupt the business operations of B---.

The proposed sale by B--- is affected by several Federal laws. For example, the sale requires filings to comply with the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C.A. §18(a), and the Exon-Florio Amendment, Section 721 of Title VII of the Defense Production Act of 1950. In addition, the proposed sale is impacted by the Worker Adjustment and Retraining Notification Act (“Warn”), 29 U.S.C. §§ 2101, et seq., which requires every “employer” to give at least 60 days advance notice of a “plant closing” or “mass layoff.” For purposes of WARN, an “employer” is a business enterprise, such as B---, that employs 100 or more employees (excluding part-time employees) or 100 or more employees who in the aggregate work at least 4,000 hours per week (exclusive of hours of overtime). 29 U.S.C. § 2101(a)(1). A “plant closing” is the permanent or temporary shutdown of a single site of employment or one or more facilities or operating units within a single site of employment, if the shutdown results in an “employment loss” at the single site of employment during any 30-day period for 50 or more employees excluding any part-time employees. 29 U.S.C. § 2101(a)(2). A “mass layoff” is a reduction in force which is not the result of a plant closing and results in an “employment loss” at the single site of employment during any 30-day period for (1) at least 33% of the employees (excluding any part-time employees) and at least 50 employees (excluding any part-time employees), or (2) at least 500 employees (excluding any part-time employees). 29 U.S.C. § 2101(a)(3). For this purpose, an “employment loss” is an employment termination (other than a discharge for cause, voluntary departure, or retirement), a layoff exceeding 6 months, or a reduction in hours of work of more than 50% during each month of any 6-month period. 29 U.S.C. § 2101(a)(6).

B--- has been advised by its labor counsel that the Department of Labor has indicated that a sale of a business, if structured as an asset sale, will be viewed as an “employment loss” triggering notice requirements under WARN notwithstanding the fact that the purchaser will hire all the employees of the business. On the other hand, a transfer of the assets and employees to a wholly-owned subsidiary should not be deemed an “employment loss” triggering notice requirements. Consequently, in order for B--- to postpone notification of its employees and still be in compliance with WARN, B--- has structured the sale as a transfer of its assets (and none of its indebtedness) to a newly-created subsidiary on the closing date solely in exchange for the initial issuance of stock by such subsidiary. Thereafter, B--- will sell the stock to K---.

Such a sale of stock will also satisfy the requirements of the sale to K--- that the hinge business be physically segregated from the remainder of B---’s operations and operated post-acquisition in a separate legal entity to facilitate calculation of profits for certain contingent price and consulting provisions. In addition, isolation of the hinge business in a separate corporation will provide K--- with a method of limiting its exposure to liabilities of operating the hinge business.

OPINION

Based on the facts set forth above, it is the opinion of the Board’s legal staff that the proposed transfer of all of the assets and none of the indebtedness of the hinge business operated by B--- to a newly-created subsidiary solely in exchange for the stock of such subsidiary, followed by the sale of such stock to K--- will not be a taxable transaction for purposes of the California Sales and Use Tax Law.

DISCUSSION

In general, the sale of tangible personal property associated with the business of a retailer for which a seller's permit is held constitutes a taxable sale for California sales tax purposes. However, among the exceptions to taxable treatment are two provisions which apply to the B--- transaction. Section 6006.5(b) of the California Revenue and Taxation Code exempts any transfer of all or substantially all the property held or used by a person in the course of activities for which he is required to hold a seller's permit when after the transfer the "real or ultimate ownership" of the property is substantially similar to that which existed before the transfer. In addition Section 1595(b)(3) of the Sales Tax Regulations exempts transfers of property to a commencing corporation in exchange solely for the first issue of stock of the corporation, except to the extent the transferor receives consideration such as cash, notes, or assumption of indebtedness. Each of the foregoing exemptions should apply to the proposed transfer of assets by B--- to a newly-created subsidiary.

In the case of the asset transfer by B---, B--- is receiving 100% of the stock of the newly-created subsidiary in exchange for substantially all of its hinge manufacturing business (exclusive only of real property), and consequently, will meet the requirements of Revenue and Taxation Code Section 6006.5(b). In addition, the transfer constitutes a transfer to a commencing entity and the exemption of Sales and Use Tax Regulation Section 1595(b)(3) should apply because the sole consideration being received by B--- will be the stock of the commencing corporation; B--- will be receiving no other consideration and the subsidiary will be assuming no indebtedness of B---. Moreover, the transfer to the subsidiary is being undertaken for the valid business purposes of (i) maintaining compliance with federal labor laws in a manner to minimize the potentially disruptive impact on the B--- labor force of premature notice of a possible sale, and (ii) separating the B--- business into a distinct legal entity to facilitate accounting segmentation and to limit K---'s exposure to liabilities. Thus, the proposed structure is supported by substantial and valid business purposes.

Under such circumstances, it is clear that the exemptions to the sales tax are applicable and that no sales tax should be owed as a result of the transfer of the hinge business to a commencing corporation followed by the sale of such stock to K---.

Please feel free to contact me if you have any questions or would like additional information.

Very truly yours,

Gary Jugum
Assistant Chief Counsel