395.1847 Occasional Sale

DJH

Out-of-State - Auditing (DMA) March 5, 1975

Legal Counsel (HLC) - Headquarters

[redacted] [redacted]

This is in reply to your memorandum dated December 31, 1974, in which you inquire as to the sales and use tax consequences of a change in business form of subject taxpayer from a partnership to a close corporation.

We understand that [redacted] was originally a partnership composed of [redacted], successor to the interest of [redacted] and [redacted] Each of the two partners had an equal interest in the partnership. The partnership was primarily engaged in the business of producing materials which are used in the production of plastic resins. Because [redacted] wished to make a substantial additional investment to improve the profitability of the partnership and [redacted] was unwilling to increase its investment in the partnership, the business was reorganized.

In accordance with the terms of an agreement between the partners, a corporation was formed, and all assets and liabilities of the partnership were transferred to the commencing corporation in exchange for stock in the corporation. Three classes of stock were issued: Class A Common Stock representing 50% of the capitalization of the corporation, Class B Common Stock representing 12½% of the capitalization of the corporation, and Preferred Stock representing 37½% of the capitalization of the corporation. The holders of Class B Common Stock were entitled to elect one and only one member of the Board of Directors of the corporation. Included in the agreement and in the Articles of Incorporation was provision for redemption of the Preferred Stock and of the Class B Common Stock under certain specified, business conditions at the option of the corporation. The redemption option expires December 31, 1980. The stock as noted was issued to the partnership, which then was dissolved. On dissolution of the partnership the Class A Common Stock was distributed to [redacted] and the Preferred Stock and the Class B Common Stock was distributed to [redacted]

It is our opinion that the transfer of property from the partnership to the corporation was an occasional sale and thus exempt from tax.

Section 6006.5(b) of the Revenue and Taxation Code provides that "occasional sale" includes the transfer of all or substantially all the property held or used in the course of activities for which a seller's permit is required when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer. The partnership transferred all of its property to the corporation, thus meeting the first requirement. [redacted] and each owned identical 50 percent interests in the partnership before the transfer. Subsequent to the transfer, [redacted] owned stock representing 50 percent of the equity of the corporation, and because of the method of classification of the stock, it also controlled the Board of Directors. In addition, because of the provision for redemption of the other classes of stock, it was possible that [redacted] could become the sole stockholder in the corporation at some time in the future. Subsequent to the transfer [redacted] owned stock representing 50 percent of the equity of the corporation, all of which was subject to redemption under the conditions specified. Although the partners did not receive identical interests in the corporation, the ultimate ownership was substantially similar to that which existed before such transfer. There was a legitimate business purpose for the reorganization other than tax avoidance. There was no certainty that shares would be redeemed, and could not directly cause to occur those conditions that would permit redemption. The corporation was not merely a conduit created to permit easy acquisition of [redacted] interest in the business. Finally, subsequent to the transfer and for some finite time period thereafter, each partner did in fact have equal real and ultimate ownership in the corporation including the tangible personal property that was transferred from the partnership. The transfer therefore qualifies as an occasional sale. Section 6367 exempts from tax the gross receipts from occasional sales. The transaction was therefore exempt.

The transaction could also qualify as a transfer solely in exchange for first issue stock. However, since the corporation assumed liability for the partnership obligations, tax would apply to that amount of the obligations assumed that is attributed to the tangible personal property transferred.

HLC:bs