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Withdrawal of Partnership Assets

Your letter of October 17, 1955, to Principal Sales Tax Auditor has been referred to me for reply.

You ask whether in the withdrawal of partnership assets by members of a partnership is subject to sales tax, and, if so, under what circumstances is such a withdrawal subject to tax.

Under Bulletin 45-1 and 48-8 no tax arises by reason of the dissolution of a partnership and distribution of the partnership's assets. The same result would obtain under Section 6006.5(b) of the Sales and Use Tax Law where the dissolution results in a distribution of 80%, or more, of the tangible personal property held or used in an activity where a sellers permit is required, and where that property is distributed to the partners as co-tenants in accordance with their partnership interest.

A more difficult problem arises when the distribution is in the nature of a liquidation and is of an amount less than 80% of the tangible personal property. No hard and fast rule can be set up at this time to govern such transactions. Each distribution must be governed by its own particular facts. As a general rule, the criteria for taxing or exempting a partial liquidation would be as follows:

1. Where the partial liquidation is in form and reality a liquidation, tax should not apply. For example, where a partnership desires to liquidate one portion of its business and the assets relating to that portion are distributed free and clear of any liabilities to the partners in accordance with their interest in the partnerships assets, we think the distribution should not be subject to tax.

2. Where the transfer is in a form a partial liquidation but is in fact a mere sale of assets, the transaction should be treated as a sale. An example of this is the transactions covered in the audit of to which you refer in your letter.

The answers to questions which you ask, in the light of the above discussion, are: Question 1: yes; question 2: no; question 3: no; question 4: no.

The letters to which you refer concerning the handling of the distribution of assets to stockholders of corporations were governed by the criteria mentioned above. The transaction in the letter of August 14, 1951, was considered a sale because the transaction was more in the nature of a sale than a genuine liquidation. The letter of May 24, 1955, was one involving the situation in which the corporation had distributed substantially all of its tangible personal property to its stockholders as co-tenants in proporation to their interest in the corporation.

John H. Murray

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