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395.2161

Step transactions
Corp. Reorganization

February 15, 1967

[redacted]

Dear [redacted]

This is with reference to the petition for redetermination filed on behalf of [redacted]

We acknowledge receipt of your letter dated January 27, 1967, and have reviewed it in detail in light of the arguments supporting a finding that the [redacted] transaction should not be subject to sales tax.

Summarily, [redacted] transferred its assets to [redacted] and in turn, [redacted] issued some of its preferred stock to [redacted]. The stock was held in trust pending the recall of outstanding [redacted] stock and the issuance of the [redacted] stock for the [redacted] stock.

We see three separate and distinct steps in accomplishing the consolidation as the [redacted] officers have termed the transaction:

One, assets were exchanged for stock in an already existing corporation.

Two, stock was exchanged for stock.

Three, the [redacted] was dissolved.

The change in corporate names, etc., does not alter the above three basic and separate acts.

The transaction is admittedly not a statutory merger.

A transfer of tangible personal property for stock in an existing corporation is a sale within the meaning of the term as defined in the Sales and Use Tax Law.

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It may be true that the transaction was such that it did not result in internal revenue tax disadvantages, but that does not negate the application of the California Sales and Use Tax Law.

A firm may give some of its assets to a charity. Assets, for example, that it purchased ex tax for resale. It would be allowed certain deductions for income tax purposes, but it would be liable for use tax nonetheless.

In matters of tax liability, substance is generally preferred to form, and is often determinative of tax consequences; however, if a taxpayer having a choice of methods of accomplishing an economic or business result pursues a particular method he must abide the tax consequences of his choice even though another method would have resulted in less severe or non-existent tax consequences. Freeman v. Commissioner, 303 F.2d 530.

In Black Point Aggregates v. Niles Sand and Gravel Co., 188 Cal. App. 2d 577, the court said:

> There is a strong indication that here, as so often occurs, the glittering possibility of outwitting the Director of Internal Revenue blinded the parties to obvious defects in other elements of their agreements.

In Zalk Joseph Co. v. Commissioner (1951) 10 TCM 662, the court said:

> Tax consequences result from what did in fact transpire, not what could have.

The following two Tax Counsel Opinions, appearing in the California Tax Service at pages 3518a and 3523, respectively, are in point and indicate the position taken by the board in matters similar to the one at hand.

395.2100

> A transaction between two or more corporations that involves the sale of all of the assets of constituent corporation/s for stock in a continuing corporation and which is followed by dissolution and liquidation of the constituent corporation/s is not a statutory merger exempt from sales tax. Such transactions are

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corporate reorganizations within the meaning of section 23251(c) of the Revenue and Taxation Code, but are de facto mergers. An exempt statutory merger arises when provisions of Title 1, Division 1, Part 8, Chapter 3, of the California Corporations Code are followed. 12-8-64.

A statutory merger is a merger pursuant to section 4100 et seq., of the California Corporations Code or similar laws of the approved merger agreement with the Secretary of State, the transferor corporation ceases to exist and without other transfer its assets and liabilities become the assets and liabilities of the surviving corporation.

In a sale the transferor receives the consideration for the transfer of its assets and may, or may not, dissolve and distribute the consideration to its shareholders. 3-9-66.

The foregoing opinions represent the position taken by the board, and are the result of conferences with the Attorney General. Statutory mergers have been held to be exempt transactions, not because of what they are called, but because the procedure in effecting the merger does not result in a sale of tangible personal property where it is acquired by the surviving corporation.

A copy of schedule 1A of the audit work papers was sent to your client. This shows the audit procedure for arriving at the measure of the tax.

We cannot conclude that [redacted] was merely a conduit. It was a legally recognized going concern that chose, through its officers, directors, a method of accomplishing a reorganization which was assented to by the majority of the shareholders.

We cannot ignore what, in fact, did happen and give full weight to what could have happened. There is an adage often used in tax questions such as is presented here, which goes: "If the motorist chooses to take the toll road he must pay the toll even though he could have gone another way and escaped the toll."

The foregoing are our reasons for recommending that the matter be redetermined without any adjustment.

If, after considering our recommendation and reasons

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[redacted]

February 15, 1967

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therefor, your client wishes to have the matter heard by the Board, please notify us in writing within three weeks.

Very truly yours,

Robert H. Anderson
Associate Tax Counsel

RHA:dse

cc: [redacted]

[redacted] Pasadena on December 13, 1966.

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