

San Diego - Auditing (WLW)

July 30, 1964

Tax Counsel (PM)

"X"

You have asked for our opinion on the taxability of the following transaction:

"X", a grocery store lessor, held a seller's permit in order to operate specific locations for short interim periods between lessees. It had two wholly owned subsidiaries which were also required to hold sellers' permits: "Y" and "Z". On February 21, 1964, "X" entered into an agreement whereby it agreed to sell to certain buyers all of its own property and the property owned by "Y", "Z", and "A" (another subsidiary). The agreement provided that before the effective date of sale the subsidiaries would be merged into "X". As modified by subsequent agreement, the effective date was the close of business March 15, 1964; the closing date, March 17, 1964. The merger of the parent and the subsidiaries occurred on March 17, 1964, upon the filing of a certificate of ownership pursuant to Section 4124 of the Corporations Code. Hence, the merger did not actually occur before the so-called "Effective Date" of sale.

The question raised by these facts is whether the tax applies not only to the transfer of equipment held or used by "X" in a taxable activity, but also to the transfer of equipment held or used in the taxable activities of "Y" and "Z".

Section 6006.5 of the Sales and Use Tax Law defines an "occasional sale" as including "A sale of property not held or used by a seller in the course of an activity for which he is required to hold a seller's permit, provided such sale is not one of a series of sales sufficient in number, scope and character to constitute an activity requiring the holding of a seller's permit." We assume that the transfer of assets by "X" was not one of a series of equipment sales. The precise question, therefore, is whether the property acquired by merger can be regarded as being held or used by "X" in the course of an activity requiring a seller's permit.

It is our conclusion that the property should be so regarded because the seller was not a new entity separate and distinct from the merged corporations. On the contrary, the subsidiaries became a part of the parent company, and the latter became the holder of all their rights and interests. In other words, the separate existence of the subsidiaries was terminated by the merger, but their rights and interests were absorbed by the surviving corporation.

The general effect of a merger is set forth in Section 4116 of the Corporations Code. This section provides, in part, as follows:

July 30, 1964

"Upon merger or consolidation pursuant to this article, the separate existence of the constituent corporations ceases, and the consolidated or surviving corporation shall succeed, without other transfer, to all the rights and property of each of the constituent corporations, and shall be subject to all the debts and liabilities of each, in the same manner as if the consolidated or surviving corporation had itself incurred them."

The effect of a merger of a wholly owned subsidiary pursuant to Section 4124 is described in similar terms, as follows:

"Thereupon, all of the estate, property, rights, privileges and franchises of the merged corporation shall vest in and be held and enjoyed by the parent corporation as fully as the same were before held and enjoyed by the merged corporation but subject to all liabilities and obligations of the merged corporation and the rights of all creditors thereof."

Interpreting comparable provisions in the Bank Act of 1909, the court in Mutual Building and Loan Association of Pasadena v. Wiborg, 59 Cal. App. 2d 325, held:

"Although the distinct corporate entity of Title Guarantee passed out of existence or became extinct upon the completion of the act of consolidation, its corporate activities did not cease but were continued and carried on through a new channel...The consolidation did not create an entirely new entity but 'merely directs the blood of the old corporation into the veins of the new, the old living in the new.'"

In E. & J. Gallo Winery v. Commissioner of Internal Revenue, 227 F.2d 699, the court considered the question of whether or not, after a merger pursuant to the California statutes, a surviving corporation is entitled to carry over any unused excess profits credit of the merged corporation. Citing the Mutual Building case, the court found that, under California law, the old corporation became an integral part of the surviving corporation. It ruled, accordingly, that the surviving corporation was the "taxpayer" entitled to use the excess profits tax credit of the merged corporation.

The above cases appear to be authority for the proposition that the assets formerly owned by its subsidiaries were held or used by "X" in an activity requiring a seller's permit. It may be true that the taxable activity was conducted by one "person" and the sale of assets was made by another. However, for at least a moment of time, the activities of the merged corporation became the activities of the surviving corporation. It seems reasonable to conclude, therefore, that the activities of the subsidiaries may be attributed to the surviving corporation for sales tax purposes.