



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) (916) 445-2641

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April 9, 1993

BURTON W. OLIVER
Executive Director

Mr. D--- B. F---
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Dear Mr. F---:

This is in response to your letter of March 11, 1993. You requested our opinion regarding the application of sales or use taxes to a "step transaction". Please be advised that before you may rely upon our written opinion your request must meet the requirements of Rev. & Tax. Code § 6596. Your request does not meet those requirements, but we are pleased to give you our opinion based on the information provided.

You provided the followings facts. A partnership forms a wholly owned corporation (Newco). Five other corporations are merged into Newco in a statutory merger in accordance with California Corp. Code §§ 1100-1305. The shareholders of the five other corporations receive cash or a promissory note in cancellation of their shares. Newco is then dissolved into the partnership, with the partnership receiving all the assets in a complete liquidating distribution.

If we look at each step separately, no sales or use taxes are applicable to any of the separate steps in the transaction. Although other business purposes are stated, it could be argued that the only real reason for this step transaction is for the partnership to acquire for cash and/or promissory notes, the tangible personal property of the five corporations without incurring a sales or use tax. If it were determined that that was the sole substantive motive, the intervening steps would be ignored and the only relevant factors would be that cash or promissory notes were paid by the partnership for the acquisition of the tangible personal property. Unless such a purchase were otherwise exempt, e.g. - an occasional sale under Rev. & Tax. Code § 6006.5(a), a sales or use tax would apply.

The U.S. Supreme Court stated: "To permit the true nature of the transaction to be disguised by mere formalism, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies...." Commission v. Court Holding Co. (1944) 324 U.S. 331, 334.

In a California case in which the "step" entities wanted to be treated as one entity, the California Supreme Court agreed. Mapo, Inc. v. State Board of Equalization (1975) 53 Cal.App.3d 245.

The Board has previously considered a sales tax avoidance scheme between related parties, for example:

Sale and Leaseback, Arms Length Transactions. Tax evasion occurs when taxpayer, a corporation and the manufacturer of mechanical equipment, sells the equipment at cost to the sole owner of the corporation who pays sales tax on the equipment and leases it back to the corporation ex-tax. The corporation then rents the equipment without collecting a use tax. Although such a transaction might be proper if there was true separation of the identifies of the parties, the sale and leaseback transaction is not at arms length and the sale at cost, rather than at fair market value, indicates an attempt to evade the use tax the manufacturer would be required to collect if he rented the equipment himself. (Business Taxes Law Guide Annotation 330.2800 (8/14/69).

If you have further questions, please contact me.

Sincerely,

Donald L. Fillman
Tax Counsel

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