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September 24, 1993

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*Executive Director*

Mr. D--- B. F---  
C--- & L---  
XXX --- ---  
---, CA XXXXX

Dear Mr. F---:

This is in response to your letter dated July 22, 1993 in which you state:

"This is a request for a legal opinion regarding the application of sales or use taxes to a business transaction between our client and another party. The sequence of events, as contemplated, is as follows:

"A. A California corporation (hereinafter 'Transferor') will transfer all of its tangible personal property used in activities requiring the holding of a seller's permit or permits to its wholly-owned subsidiary Delaware corporation (hereinafter 'Acquisition'). Concurrently, Transferor will also transfer to Acquisition various other assets including leaseholds and intangibles. The only assets to be retained by Transferor are certain intangibles, real property, and a small amount of assets not used in the activity requiring the holding of a seller's permit. Simultaneous with the transfer of the assets, Acquisition will assume a substantial portion of the liabilities of Transferor related to the operation of the business.

"B. Immediately following the transfer of assets and the assumption of liabilities, Acquisition will be merged with and into a separate Delaware corporation (hereinafter 'Transferee'). The separate existence of Acquisition will cease, and Transferee, as the surviving corporation shall continue to exist. Acquisition and Transferee will file a Certificate of Merger with the Secretary of State of the State of Delaware. The

outstanding capital stock of Acquisition will be converted into the right to receive an aggregate amount equal to the Merger Consideration.

"C. On the closing date, after filing the certificate of merger, Transferee will pay to Transferor the Merger Consideration, consisting of cash and a note.

"There are valid business reasons for structuring the transaction in this manner, including additional insulation of Transferee from potential liabilities."

You ask whether you are correct in concluding that the transaction, if completed in the manner described above, will result in no California sales or use tax liabilities on the part of any of the companies involved in accordance with Regulation 1595(b)(2) and (3).

Since Acquisition is assuming liabilities of Transferor and assumption of liabilities is consideration (Regulation 1595(b)(4)), the transfer of the assets from Transferor to Acquisition is a sale. Thus the first question is whether this sale is an exempt occasional sale under Revenue and Taxation Code sections 6367 and 6006.5(b).

Revenue and Taxation Code section 6367 exempts from tax the gross receipts from occasional sales of tangible personal property and the storage, use, or other consumption in this state of tangible personal property, the transfer of which to the purchaser is an occasional sale.

Revenue and Taxation Code section 6006.5(b) includes in the definition of occasional sale transfers of all or substantially all property without a substantial change in ownership. The requirements for this type of occasional sale exemption are set forth in Regulation 1595(b)(2), which reads in part:

"(2) TRANSFERS OF SUBSTANTIALLY ALL PROPERTY WITHOUT SUBSTANTIAL CHANGE IN OWNERSHIP. Tax does not apply to a transfer of all or substantially all the property held or used by a person in the course of activities for which the person is required to hold a seller's permit or permits or would be required to hold a seller's permit or permits if the activities were conducted in this state, provided that after the transfer the real or ultimate ownership of the property is substantially similar to that which existed before such transfer. 'Substantially all the property' means 80 percent or more of all the tangible personal property held or used in the course of activities, including tangible personal property located outside of this state.... Stockholders, bondholders, partners, or other persons holding an ownership interest rather than a security interest in the corporation or other entity are regarded as having the real or ultimate ownership of the property of the corporation or other entity.

"The real or ultimate ownership is 'substantially similar' to that which existed before a transfer if 80 percent or more of that ownership of the tangible personal

property is unchanged after the transfer...."

According to your letter, the 80 percent rule relating to the transfer of substantially all of the property is met because Transferor will transfer all of the tangible personal property used in activities requiring the holding of a seller's permit.

We assume that Transferor will own all of the stock of Acquisition immediately after the sale of the property. We also assume that Transferee is unrelated to Transferor. The next question, therefore, is whether the rule relating to substantially similar ownership is met where the property is first transferred to a wholly-owned subsidiary and then immediately transferred by merger to an unrelated corporation. It is our position that if there is a valid business purpose for structuring the transaction in this manner other than the avoidance of sales or use tax, the substantially similar ownership requirement will be met since the transfer was to Transferor's wholly-owned subsidiary.

Because the requirements of section 6006.5(b) are met, the sale of property to Acquisition will qualify as an exempt occasional sale under section 6367.

The final question is whether the transfer by statutory merger of the property from Acquisition to Transferee is subject to tax. If Delaware has statutory merger laws similar to those of California, under Regulation 1595(b)(3) tax does not apply to the transfer of the property of Acquisition to Transferee pursuant to the statutory merger.

Revenue and Taxation Code section 6596 provides the only basis for relief from tax if a taxpayer relies on incorrect written advice from the board. The primary conditions to qualify are that the request for opinion must be in writing and must disclose all relevant facts, including the identity of the taxpayer. Since you have not identified your client, this opinion does not come within the provisions of section 6596 but rather is simply general advice regarding a set of hypothetical facts.

If you have further questions regarding Sales and Use Tax Law, please do not hesitate to write again.

Sincerely,

Elizabeth Abreu  
Tax Counsel

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