

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
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August 30, 1988

Mr. L--- E. J---  
XXXX --- --- Drive  
--- ---, CA XXXXX

Dear Mr. J---:

This is in response to your letter dated August 12, 1988 regarding the application of sales tax to transfers of assets between partially related entities.

The first transaction involves a transfer of assets from IJK to RST. In 1984, RST invested \$13 million in IJK and received 1,500,000 shares of Preferred Series A and 500,000 shares of Preferred Series B stock. Other investors own 306,000 of common stock of IJK with outstanding options to purchase 19,000 shares of common stock. IJK will be dissolved and all its assets will be transferred to RST in exchange for debt owed to RST. RST will also pay the common stockholders of IJK the payment which they have been guaranteed for their stock. RST will then contribute the assets of IJK to a joint venture.

You ask whether the transfer of assets from IJK to RST satisfies the 80 percent rule of Regulation 1595(b)(2) for substantially similar ownership. When all ownership interests in a corporation are represented by one type of stock, it is easy to determine whether the 80 percent rule is satisfied: if the transferee owns at least 80 percent of that stock, the ownership will be substantially similar after the transfer. However, all persons holding an ownership interest in a corporation, including both preferred and common stockholders, must be included in calculating ownership interests when there are two or more types of ownership interests that must be compared to determine their relative values. Ownership will be substantially similar after the transfer only if the transferee owns 80 percent of the total value of the corporation, and this calculation may require an audit of the actual books of the corporation.

You also ask whether RST's transfer of assets to the newly formed joint venture will be subject to sales tax. You state that the transfer will be in exchange for an interest in the newly formed joint venture with no assumption of liability. Assuming there is no other consideration received by RST for the transfer, sales tax will not apply to the transaction. (Reg. 1595(b)(4).)

If you have further questions, feel free to write again.

Sincerely,

David H. Levine  
Tax Counsel

DHL:rar

bc: --- --- - District Administrator