

STATE OF CALIFORNIA

395.1578

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)
 for Redetermination Under the) DECISION AND RECOMMENDATION
 Sales and Use Tax Law of)
)
 ---Petitioner) No. ---
)
)
)
Petitioner)

The Appeals conference in the above-referenced matter was held by Staff Counsel Michele F. Hicks on February 16, 1994 in Sacramento, California.

Appearing for Petitioner:

- A
President
- B
Manager
- C
Taxpayer's Representative
- D
Certified Public Accountant

Appearing for the
Sales and Use Tax Department:

Mr. Kevin Johnson
Senior Tax Auditor

Protested Item

The protested tax liability is measured by \$113,252, the purchase price of a vessel.

A 10 percent penalty was added for failure to file a return.

Petitioner's Contentions

1. The sailboat was acquired in a transfer of substantially all of the property of a corporation and the ultimate ownership of the property is substantially similar to that which existed before the transfer.

2. The sailboat was originally purchased for resale and the seller was a retailer of boats. Therefore the seller is liable for sales tax on the transaction.

Summary

---Petitioner is a California corporation wholly owned by its President, A.

Prior to forming petitioner, Mr. A was the President of X. X was owned 50 percent by Mr. A and 50 percent by AA, his wife. X owned a 40-foot 1983 -- sailboat, "Y".

Mr. A petitioned for divorce and on February 11, 1988, the parties signed a Marital Settlement Agreement (hereafter "Agreement"). The Agreement was approved by the court on February 17, 1989.

The Agreement provides for the division of A and AB's community assets. Paragraph 2.13 awards AB all of the interest of the parties in X including all debts. Paragraph 1.10 awards A the sailboat together with all debts secured by the boat. Paragraph 1.10 is lined out and initialled by the parties. An attachment to the Agreement states that Mr. A shall buy the sailboat from X at the current loan balance and that based on his accountant's advice, Mr. A may purchase the boat through a corporation.

X transferred the boat to ---Petitioner on February 17, 1989. The audit staff contends that this was a sale of the boat from one corporation to another and therefore is a taxable transaction.

Petitioner contends that the sailboat was acquired in a transfer of substantially all of ---Petitioner's property and the ultimate ownership of the property is substantially similar to that which existed before the transfer. Alternatively, petitioner contends that the boat was originally purchased for resale and X was a retailer of the boat. Therefore, when X sold the boat to ---Petitioner, it was a sales tax transaction and tax should be assessed against X.

Analysis & Conclusion

I find that the evidence presented does not support either one of petitioner's

contentions. However, because I believe that petitioner should prevail on another ground, for the sake of brevity, I will not expand on my rejection of petitioner's contentions. If, after reading the analysis and conclusion stated in this Decision and Recommendation, either side appeals my recommendation and further discussion of these two contentions becomes necessary, I will give a full analysis in a Supplementary Decision and Recommendation.

Revenue and Taxation Code Section 6281 provides that the gross receipts from the sale of and the storage, use, or other consumption of a vessel are exempt when the vessel is included in any transfer of all or substantially all the property held or used in the course of the business activities of the person selling the property, when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before the transfer. For the purposes of Section 6281, "stockholders, bondholders, partners, or other persons holding an interest in a corporation or other entity are regarded as having the `real or ultimate ownership' of the property of that corporation or other entity".

Business Taxes Law Guide Annotation 395.2420 states:

"Property Settlement, Example of Particular Non-taxable. Taxpayer owned and operated two places of business under his own name. The businesses were held by the taxpayer as community property with his wife. Upon a divorce and property settlement the husband took one of the businesses as his separate property and the wife took the other business as her separate property.

"It is our opinion that this transaction should be regarded as analogues to a distribution of the assets of a partnership upon a dissolution. While the ownership of community property by husband and wife is not strictly speaking a partnership, it resembles a partnership in some ways and for sales tax purposes we feel that a splitting up of the community property should not be regarded as a sale." (11/25/52)

The Board's Tax Tip Pamphlet No. 23 "Occasional Sales of Vehicles, Vessels, and Aircraft" states on page 20:

"C. Involuntary Transfers - Not Subject to Use Tax

"An `involuntary transfer' might be defined as a transfer in which a transferee, because of circumstances beyond their (sic) control, assumes ownership. Such transfers would include but would not necessarily be limited to:

- "a. Repossession by a finance company.
- "b. Ownership as a result of a property settlement in a divorce.
- "c. Inheritance from an estate.
- "d. Recovery of stolen property for which an insurance company has made a full settlement to the insured owner. Upon recovery, the insurance company would assume ownership without use tax liability."

It has been the Board's position for over forty years that ownership as a result of a property settlement in a divorce is an involuntary transfer not subject to tax. In the present appeal, the audit staff has deviated from this long-standing position because the transfer technically occurred between two corporations and not the individuals themselves. We do not believe that this distinction should make a difference.

In Annotation 395.2420 quoted above, the taxpayer owned two businesses in his own name, but the businesses were community property. The Board allowed the tax free transfer of one business to his wife as separate property and the other to the taxpayer as separate property. The rationale for this decision was "for sales tax purposes we feel that the splitting up of the community property should not be regarded as a sale".

In the present appeal, A and AB each held 50 percent of the stock of X in their own names, but it was community property. In the Marital Settlement Agreement, their interests in X are included in a list designated as "[a]ll other community property owned by the parties...." Further, the last sentence of the Agreement states that "[t]he parties agree that this is a substantially equal division of their community property...." Thus the parties' interest in --- was listed in the Agreement as a community asset to be divided in the divorce.

X was a business owned as community property by a husband and a wife, just as the businesses described in Annotation 395.2420. The fact that the business was incorporated should make no difference in the tax outcome. Revenue and Taxation Code Section 6281 specifically provides that stockholders in a corporation are regarded as having "real or ultimate ownership" of the property of the corporation. Under this provision, there is no meaningful distinction between a sole proprietor who owns a business as community property and a husband and wife who own their corporation as community property. Section 6281 provides that the latter have "real or ultimate ownership" of the business property just as the former does.

The sailboat was awarded to petitioner as a result of a property settlement in a divorce. The transfer was involuntary. Petitioner took the sailboat subject to the secured debt

(i.e., the loan balance) just as AB and A took much of the rest of the community property awarded to each of them. This is a case of a husband taking his share of the community property. As stated in Annotation 395.2420, "for sales tax purposes we feel that the splitting up of the community property should not be regarded as a sale".

Petitioner has already paid \$8,379.35 on this determination. We recommend that the determination be canceled and the \$8,379.35 be refunded to petitioner.

Recommendation

Cancel the determination. Refund the \$8,379.35 that petitioner has already paid.

MICHELE F. HICKS, STAFF COUNSEL

7/28/94

DATE