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Your letter dated September 19, 1969 directed to Mr. Frank Lagomarsino has been referred to me for reply. You ask how sales/use tax would apply in the following situation:

An individual who owns and operates a sole proprietorship which renders services primarily to governmental agencies wishes to incorporate his business. He does not hold a resale permit. The plan of incorporation involves the transfer of all the proprietorship's assets at net book value and all liabilities in exchange for all the capital stock of the corporation and the corporation's note. As a result of incorporation, the net worth of the proprietorship (\$68,000) would now be recorded as Note Payable (\$30,000) and Capital Stock (\$38,000).

By "he does not hold a resale permit", we presume you mean that the individual does not hold a seller's permit. By "proprietorship which renders services primarily to governmental agencies", we presume that the individual is not a "retailer" (Sections 6015 and 6019), is not a "seller" (Section 6014), and is not required to hold a seller's permit (Section 6066).

Sales and Use Tax Law Section 6367 exempts gross receipts from occasional sales of tangible personal property from sales and use taxes. However, that section further provides that the exemption does not apply to the gross receipts from the sale of, or to the storage, use or other consumption in this state of a vehicle required to be registered under the Vehicle Code or of a vessel or aircraft as defined in Article 1 of Chapter 3.5 of the law. "Occasional sale" is defined in Section 6006.5 to include:

"(a) 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;" or,

"(b) Any transfer of all or substantially all the property held or used by a person in the course of such an activity when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer."

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Assuming that the assets sold were in fact not held or used by the individual in the course of an activity for which he was required to hold a seller's permit, the sale would qualify as an occasional sale (Section 6006.5(a)) and, with the exception of any aforesaid vehicles, vessels or aircraft, would be exempt from sales and use taxes (Section 6367), unless the sale was one of a series sufficient in number, scope and character to constitute an activity requiring the holding of a permit. If this latter situation were the case, it would be questionable whether the proprietorship renders services. In this event, the sale would not qualify as an occasional sale pursuant to Section 6006.5(a), but it would qualify as an occasional sale pursuant to Section 6006.5(b) and again, with the exception of vehicles, vessels or aircraft, would be exempt from sales and use taxes (Section 6367). The transfer would qualify because all the property held or used in the course of an activity for which the individual is required to hold a seller's permit is transferred, and because subsequent thereto, the ownership of the property is the same as that which existed before the transfer. For purposes of Section 6006.5(b), stockholders of a corporation are regarded as having the "real" ownership of the property of the corporation.

Chapter 3.5 (Sections 6271 to 6292) relates to sales of vehicles, vessels and aircraft. Section 6281 provides that the gross receipts from the sale of and the storage, use or other consumption in this state of a vehicle required to be registered under the Vehicle Code or a vessel or aircraft are exempted from sales and use taxes when such property is included in any transfer of all the property held or used in the course of a business activity of the person selling the property, and when after such transfer the ownership of the property is substantially similar to that which existed before such transfer. Thus, any vehicles, vessels or aircraft included in the assets transferred would be exempt from taxes pursuant to this section because all the property was transferred and because the ownership of the property was the same as that which existed before the transfer. For purposes of this section, stockholders are also regarded as having the "real" ownership of the property of the corporation.

In summary, sales and use taxes would not apply in the situation which you have posed. However, in considering this question we have made several factual assumptions which were necessitated by the lack of a detailed explanation of the situation in your letter. Thus, if any of these assumptions are contrary to the situation you have in mind, it is possible

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that sales or use tax might apply. In the event that the facts are other than as assumed, upon being so advised by you, we shall give further consideration to your question.

Very truly yours,

J. Kenneth McManigal  
Tax Counsel

JKM:smb