

395.1992

Report of Hearing Officer Robert H. Anderson/vs

3/29/68

Taxpayer [G]
dba [GEM] Co.
XXXX --- ---
--- ---, CA XXXXX

Account Number S- -- XX XXXXXX
Form Number 432
Date of Billing 11-0-67

Period (From 10-1-64
(To 12-31-66

Date of Hearing March 7, 1968

Time 11:00

Place San Francisco

Appeared on behalf of Petitioner

Messrs. [K] and [W],
Attorneys with the firm of
---, ---, --- & ---

See Pg. 290 & 291 Step Transactions Sale of
Stock-Exempt even though TP gives Control of
Corp.

Board of Equalization Representatives

Messrs. Jack Lyons and Fred Rohel

Comments and Recommendations

PROTESTED ITEMS:

Sale of furniture and equipment not reported \$60,967

CONTENTIONS OF PETITIONER

The transaction was a sale of stock in a corporation.

REPORT OF FACTS:

[G] (hereinafter referred to as "[G]"), doing business as [G] [E] & [M] Company (hereinafter referred to as "GEM") is a sole proprietorship operation of a machine shop that manufactures and sells precision products.

The business started on January 1, 1964. On June 26, 1965, a California corporation known as [B], [S] and [G], Inc. (hereinafter "BSG") entered into a joint venture with [G] to carry on certain operations under the name of [R].

In conjunction with the joint venture and contingent upon success of the joint venture, the business of GEM and [R] would, at the option of BSG, be incorporated into BSG by the purchase of GEM. Pursuant to this, an option to purchase was exercised on June 26, 1965, between [G] and BSG, whereby [G] would transfer the business and assets of GEM to BSG in exchange for 52 shares of stock in BSG and \$30,000 payable in annual installments of \$5,000. The term of the option was one year and 30 days notice had to be given in order to exercise.

[G] covenanted, among other things, that he would not incur any indebtedness for capital improvements or otherwise except in the ordinary course of business without the written consent of BSG.

On December 2, 1965 (five months after the granting of the option) [W], Inc. (hereinafter "[W]") was incorporated, and on that date the organizational meeting of the board of directors and incorporators was held. Mr. [G] was elected president. Mr. [G] offered to transfer, as of December 2, 1965, all assets, business and goodwill of GEM, subject to the assumption of all liabilities and obligations of GEM to [W] in exchange for 1,000 shares of [W] stock without par value. The board of directors accepted the proposal by adopting a resolution to that effect and subject to the issuance of an appropriate permit by the California Commissioner of Corporations.

On January 21, 1966, a permit was issued to [W] by the commissioner authorizing it to sell and issue 1,000 of its no par value shares to [G].

On December 2, 1965, the option arrangement between [G] and BSG was amended to provide that BSG would have an option to purchase the shares of [W] if and when [G] acquired them.

On February 11, 1966, BSG formally exercised its option to purchase the 1,000 shares of [W] from [G] and on February 17, 1966, an application for a permit authorizing the transfer of [W] stock from [G] to BSG in exchange for cash plus 52 shares of BSG was made to the Commissioner of Corporations.

A permit for this transfer was issued on March 11, 1966, and shortly thereafter the transfer or exchange was made.

[W] continued to exist as a separate and viable corporation with BSG the sole stockholder of [W]. Thus, [W] became a wholly owned subsidiary of BSG.

CONCLUSIONS:

The transaction sought to be taxed is the transfer of 1,000 shares of [W] stock by [G] to BSG in return for 52 shares of BSG and \$30,000. The stock in [W] was valid and had been issued to [G] pursuant to a permit issued by the Commissioner of Corporations. The transfer in question was perfectly legal in every respect. The only thing [G] sold was capital stock in [W]. [W] remained a legal, separate corporate entity. To hold that [G] sold tangible personal property, as was originally contemplated is ignoring the facts. This is like telling a person "You planned to go to San Jose from Oakland by the way of the Oakland Bay Bridge; however, since you changed your plans and went by way of the east side of the bay, you avoided the bridge toll. You cannot do this without still paying the bridge toll."

[G]
(S- -- XX XXXXXX)

March 29, 1968
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This transaction was perfectly legal. It was not a sham, and the state has no more right to tax this transaction than it would have to exempt it if the facts were reversed. That is, if [G] had originally planned to form a corporation and sell the stock, and changed his plans and sold the assets to BSG, who in turn incorporated them into [W].

RECOMMENDATION:

Redetermine and delete the protested item.

Adjustment to be made by petitions.

Robert H. Anderson, Hearing Officer

APPROVED:

Principal Tax Auditor

4-1-68

Date