

**M e m o r a n d u m****395.0005**

To: Mr. M. D. Coleman  
Senior Tax Auditor

Date: December 13, 1990

From: David H. Levine  
Tax Counsel

Subject: [D] I--- C---, Inc.  
SN --- XX-XXXXXX

(916) 445-5550  
ATSS 485-5550

This is in response to your memorandum dated November 30, 1989 which we received on December 13, 1989. You ask whether a sale of assets under the circumstances described below qualifies as an exempt occasional sale. Prior to the transactions in question, three relevant corporations were in existence: [A], its wholly-owned subsidiary [B], and [B]'s wholly-owned subsidiary [C]. You state that [C] owned all the U.S. assets and all the stock of the [D] foreign subsidiaries. I do not fully understand this statement; however, I assume that, as relevant to your question, you mean that [C] had certain assets. Among these assets was a plant in California consisting of real estate and tangible personal property. You have been told that the tangible personal property was acquired by [C] tax paid. [C] leased the tangible assets to [B], which operated the plant. For purposes of this opinion, I assume that this is the only activity for which [C] may have been required to hold a seller's permit.

On page 3 of your memorandum, you state that [E] was incorporated in late 1984 as a wholly-owned subsidiary of [C]. You then state that on January 1, 1985, [B] transferred all the stock of [C] to [E] for stock of [E]. This is obviously a complex transaction and without reviewing the documentation or having a more complete description, I cannot understand what actually occurred. However, these transactions do not appear relevant to our analysis since the transfers apparently involved only stock. In some manner, [C] became a wholly-owned subsidiary of [E], and the only transaction at this point that appears relevant to our inquiry is that [C] then transferred all its tangible personal property to [E] as a dividend, retaining ownership of the real estate. [E] continued the lease of the tangible property to [B].

You state that on February 15, 1985, all [D] domestic assets and all stock of the foreign [D] subsidiaries were sold to D--- I---, Inc. for cash per an agreement between [A] and D--- I--- dated January 8, 1985.

You state:

“The transfer of the M & E (machinery and equipment) to [E] was a transfer of all of the tangible assets as [C] retained only the land and buildings. (Anno. 395.1260 and Anno. 395.1500)

“The only use of the M & E by both [C] and [E] was leasing it to [B] who operated the plants. Since it was acquired tax paid, the lease to [B] by both [C] and [E] would not be subject to tax on the lease receipts. It appears to me that only [B], as lessee, used the M & E in an activity requiring a sales and use tax permit.”

There are several transactions involved here. I believe it is appropriate to review application of tax to each transaction.

#### Lease of Property to [B]

Taxpayer's representative asserts that all tangible personal property owned by [C] was acquired tax paid. If this is true, and if [C] leased that property to [B] in substantially the same form as acquired by [C], then [C]'s lease was not a sale and was not subject to tax. However, if either or both of these assumptions are incorrect, [C]'s lease of the property to [B] was subject to use tax measured by rentals payable and [C] was required to hold a seller's permit.

#### Transfer of Property to [E]

[C] then transferred the property to [E] as a dividend, but you have not stated whether [C] received any consideration for that transfer. For example, such consideration might have included an assumption by [E] of the indebtedness associated with the transferred property. Even though a “dividend,” such a transfer of tangible personal property, for a consideration, is a sale. (See BTLG Annot. 495.0725 (7/22/76).) Since [E] will continue to lease the property to [B], we must ascertain not only whether the transfer to [E] was for a consideration (and thus subject to tax unless specifically exempted or a sale for resale), but also whether [E] retained the same tax-paid status of the property that [C] presumably had (discussed in the next section).

As relevant to this discussion, there are two types of occasional sale. (I note that you have not described the tangible property in question. For purposes of this opinion, I assume that the property does not include vehicles, vessels, or aircraft.) A Section 6006.5(a) occasional sale is a sale of property not held or used by a seller in the course of activities for which it is required to hold a seller's permit. A Section 6006.5(b) occasional sale is a transfer of all or substantially all of the property held or used by a person in the course of activities requiring a seller's permit when after the transfer the real or ultimate ownership of the property is substantially similar to that which existed before the transfer. A person engaged in a business not requiring a seller's permit cannot make a transfer that comes within the provisions of Section 6006.5(b).

If [C] leased the property to [B] in substantially the same form as acquired, and if the property had been acquired by [C] tax paid, [C] was not required to hold a seller's permit. If [C] thereafter received consideration from [E] for the transfer of the property, that transfer was a Section 6006.5(a) occasional sale. However, please note that if such property not used by [C] in the course of activities requiring a seller's permit were transferred to [E] for no consideration, there would have been no Section 6006.5(a) occasional sale: no tax applies since there would have been no sale at all.

If, on the other hand, the property leased by [C] to [B] were not tax paid, or were not leased in substantially the same form as acquired, tax applied to the rentals payable from that lease and [C] was required to hold a seller's permit. Since [C] would have transferred all its tangible personal property used in activities requiring a seller's permit to its sole shareholder, that transfer would have been a Section 6006.5(b) occasional sale. (See Reg. 1595(b)(2) (80% of tangible personal property used in activities requiring seller's permit).) Please note that this would have been a Section 6006.5(b) occasional sale even if there had been no consideration for the transfer since Section 6006.5(b) requires only that a transfer occurs.

#### Lease of Property by [E] to [B]

Although no tax applies to the transfer of property from [C] to [E] because the transfer was a Section 6006.5(a) occasional sale exempt under Section 6367, or was not a sale at all, or was a Section 6006.5(b) occasional sale exempt under Section 6367, this does not answer the question of how tax applies to the lease by [E] to [B]. [E] apparently did not pay tax or tax reimbursement with respect to the transfer of property to it and would have retained the tax-paid status of that property only if it received the property in a transaction that was a Section 6006.5(b) occasional sale. (Rev. & Tax. Code § 6006(g)(5) (A).) But [E] would have acquired that property in a Section 6006.5(b) occasional sale only if [C] did not hold the property tax paid. (If the property were tax paid, [C] would not have been required to hold a seller's permit and the transfer would have been a Section 6006.5(a) occasional sale or no sale because no consideration.) Since [E] presumably did not make an election under Section 6094.1 to pay tax on purchase price, its lease to [B] was a taxable sale regardless of whether the transfer to it was a Section 6006.5(a) occasional sale, a Section 6006.5(b) occasional sale, or no sale at all.

#### The Sale to D--- I---

If [E] sold its assets to D--- I---, it would have sold property it held in the course of activities requiring a seller's permit. While the sale may have been of substantially all the assets used by [E] in such activities, the real or ultimate ownership of that property would not have been substantially similar after the transfer to that which existed before the transfer. Therefore, that sale would not have been an exempt occasional sale. However, your description of this transaction does not indicate that this is what occurred. You state that [A], which is the parent of [B], which is the parent of [E], made a sale to D--- I---. Nothing in your memorandum indicates that [A] owned any tangible personal property as related to your inquiry. The person owning the subject property was [C] and then [E] ([A] owned the shares of [B] which owned the shares of

[E]). It appears that [A] may have transferred shares (of [B]?) to D--- I---. Shares are not tangible personal property and their sale is not subject to sales tax. If this transaction did involve the transfer of tangible personal property and this opinion does not answer your question with respect to the application of tax to that transfer, please write again and fully describe the transaction. Copies of relevant contracts would be helpful if the transaction is more complicated than a simple sale.

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**M e m o r a n d u m****395.0005**

To: Mr. Jack E. Warner  
Out-of-State District  
Principal Auditor

Date: March 18, 1991

From: David H. Levine  
Senior Tax Counsel

Subject: [D], Inc.  
SN --- XX-XXXXXX

(916) 445-5550  
ATSS 485-5550

In response to an inquiry from the Houston Out-of-State District office, I responded in a memorandum dated January 11, 1990. In a memorandum dated January 11, 1991 to the Principal Tax Auditor, you questioned my opinion. Since your memorandum asks for reconsideration of my opinion, it has properly been referred back to me.

As noted in my previous memorandum, the facts included in the inquiry memorandum were not particularly clear. The facts included in your memorandum are not ambiguous, and as quoted below, are the facts upon which this memorandum is based:

“Prior to 1985, M--- I--- Inc. ([D]) and [E] were both wholly owned subsidiaries of E--- I--- Inc. ([B]). [E] was an inactive corporation. [D]’s activities consisted of leasing machinery and equipment (M & E) to [B] and acting as a holding company owning stock in certain foreign subsidiaries. Machinery and equipment leased in California was purchased tax paid. The lease was therefore not a ‘sale’ and ‘purchase’ and [D] was not required to hold a seller’s permit.

“In January 1985, [B] contributed the stock of [D] to [E], resulting in [D] being a wholly owned subsidiary of [E]. [D] then distributed its M & E assets (which represented 100% of its tangible personal property) to [E] as a dividend in kind, with the lease of the subject M & E to [B] continuing uninterrupted.

“In February 1985, [B] sold the manufacturing business wherein the subject M & E was being used to D--- I---, an unrelated company. At the same time, [E] sold the subject M & E to D--- I---.”

You state that your primary concern is that, upon transfer of the property from [D] to [E], my opinion would change an ongoing lease which is not a “sale” to one which is. This was

definitely not the intent of my opinion. My opinion was based upon ambiguous facts as well as my failure to make an obvious assumption. In reviewing the circumstances now, the obvious assumption was that the property was transferred from [D] to [E] subject to an ongoing lease. However, this was not specifically stated in the incoming memorandum and I failed to focus on this aspect. Rather, my opinion was based upon the interpretation of the statement "[E] continued the lease" to mean that a new lease was entered into after the transfer.

Based upon the understanding that the property was transferred subject to an existing and ongoing lease, you are correct. We would never convert an ongoing tax-paid lease of tangible personal property into a lease constituting a "sale" by virtue of the sale of the property from the lessor to a third party subject to the existing and ongoing lease. Therefore, the lease from [E] to [B], which was the same lease as between [D] and [B], did not constitute a "sale" because [D] leased the property to [B] in substantially the same form as acquired and presumably timely paid sales tax reimbursement or use tax measured by purchase price.

The other point which you question in my previous memorandum relates to my conclusion that [E] would have retained [D]'s tax-paid status of the leased property only if the transfer to [D] was a section 6006.5(b) occasional sale, which applies only to property held or used in the course of activities requiring a seller's permit. [D]'s transfer to [E] was not a section 6006.5(b) occasional sale. (Based upon the stated facts that the property was held by [D] tax paid and there were no other activities by [D] which would have required a seller's permit, [D] was not engaged in an activity requiring the holding of a seller's permit.)

You note that the last paragraph of subdivision (b)(1)(E) of Regulation 1660 appears to extend the tax-paid status of property not used in activities requiring a seller's permit to the transferee provided the remaining requirements of section 6006.5(b) are met (substantially all the assets and substantially the same ownership after the transfer). I overlooked this provision. You are therefore correct that [E] retains [D]'s tax-paid status of the property. Of course, this is based on the taxpayer's assertion that all such property was tax paid. I assume the staff has verified this to their satisfaction. If any property were not tax paid, such as property purchased outside California with no self-reporting (e.g., property used outside California more than ninety days even if tax was paid to another state), the result in this case would be completely different.

In summary, [E] retained [D]'s tax-paid status in the leased property and its lease of that property to [B] did not constitute a sale. [E] was therefore not required to hold a seller's permit by virtue of its leases of that property. Assuming that it was not engaged in any other activity requiring the holding of a seller's permit and that its sale of its property to D--- I--- was not one of a series of sales requiring the holding of a seller's permit, that sale was an exempt occasional sale.

In the future, if you question an opinion or desire reconsideration, we would appreciate your sending your request to the attorney writing the opinion you question and copy your request to anyone you deem appropriate. In the rare case where circumstances dictate that you

direct your request to some other person, we would appreciate that as a courtesy you always copy the attorney whose opinion you are questioning. Thank you

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cc: Mr. Glenn A. Bystrom