

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
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WILLIAM K. BENNETT
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BRAD SHERMAN
Second District, Los Angeles

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Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

September 25, 1991

Mr. A--- J---. K---, President
N--- Corporation
XXX E. --- Way
--- ---, CA XXXXX

CINDY RAMBO
Executive Director

Dear Mr. K---:

Re: SR -- XX XXXXXX-010

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the determination be redetermined without adjustment except as provided in the reaudit report dated June 1, 1989 as explained in the Decision and Recommendation.

There are three options available to you at this point.

1. If, after reading the Hearing Decision and Recommendation, you believe that you have new evidence and/or contentions, you should file a Request for Reconsideration. No special form is required to file the Request for Reconsideration, but it must be filed within 30 days from the date of this letter and clearly set forth any new contentions. If new evidence is the basis for filing the request, the evidence must be included. Direct any such request directly to me, with a copy sent to the State Board of Equalization, P.O. Box 942879, Sacramento, CA 94279-0001, Attn: Principal Tax Auditor. I will subsequently notify you whether the request has been taken under review or whether the request is insufficient to warrant an adjustment. If I conclude that no adjustment is warranted, I will then notify you of the procedure you can follow to request an oral hearing before the Board.

2. If, after reading the Hearing Decision and Recommendation, you find that there is no basis for filing a Request for Reconsideration, but nevertheless desire to have an oral hearing before the Board, a written request must be filed within 30 days with Ms. Janice Masterton, Assistant to the Executive Director, Board of Equalization, P.O. Box 942879, Sacramento, CA 94278-0001.

3. If neither a request for Board Hearing nor a Request for Reconsideration is received within thirty (30) days from the date of this letter, the Hearing Decision and Recommendation will be presented to the Board for final consideration and action.

Very truly yours,

H. L. Cohen
Senior Staff Counsel

HLC:te
Enc.

cc: Ms. Janice Masterton
Assistant to the Executive Director (w/enclosure)

Mr. Glenn Bystrom
Principal Tax Auditor (file attached)

--- ---e – District Administrator (w/enclosure)

Petition Unit (w/enclosure)

STATE OF CALIFORNIA

395.1530

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:)	
)	
N--- CORPORATION)	No. SR -- XX XXXXXX-010
)	
)	
<u>Petitioner</u>)	

The above-referenced matter came on regularly for hearing before H. L. Cohen on June 19, 19XX in --- ---, California.

Appearing for Petitioner:

No appearance
(No response to Notice of
Hearing)

Appearing for the
Sales and Use Tax Department:

Mr. J. Huk
Supervising Tax Auditor
--- --- District

Mr. G. Ellis
Tax Auditor
--- --- District

Protested Item

The protested tax liability for the period January 1, 1984 through March 31, 1987 is measured by:

<u>Item</u>	<u>State, Local and County</u>
C. Unreported sales of capital assets	\$ 218,318
Less reaudit adjustment	<u>- 8,444</u>
Total	\$ 209,874

Contentions of Petitioner

Petitioner contends that the transfer of assets to its subsidiary was a contribution of capital and therefore not subject to tax.

Summary

Petitioner is a corporation which is engaged in the manufacture and sale of lenses. It also makes substantial sales of tooling. The last previous audit was for the period through December 31, 1983.

Subsequent to the issuing of the deficiency determination a reaudit was conducted. In a reaudit report dated June 1, 1989 the amount subject to tax was reduced by \$68,102 to \$252,745. This included the above noted reduction in the protested item.

On August 25, 1985, Mr. F--- L---, then treasurer of petitioner, obtained a personal loan and paid the liabilities related to the capital assets owned by petitioner. This was treated as a loan by L--- to petitioner. Petitioner executed a note dated August 28, 1985 for \$100,000 to Lodato. On September 5, 1985 petitioner issued a check for \$125,379.25 to L--- in repayment of the loan.

On August 30, 1985, petitioner's Board of Directors voted to transfer the assets in question to a wholly-owned subsidiary, P--- O--- L---, Inc. (P---), as a contribution to capital. The transfer was to be effective September 1, 1985. The transfer agreement did not mention consideration and was signed by L--- as Chairman of both petitioner and P---. The transfer was shown on the books of both entities as an investment in the amount of \$234,437.54.

On September 1, 1985, P--- contributed the assets received from petitioner to N--- P---, a joint venture, in exchange for 50% interest in the joint venture. The other joint venturer was A--- P---. A--- contributed a line of credit to the joint venture.

The Joint Venture Agreement provides in Section 4.3 as follows:

“Cash available for distribution arising from any loans to the partnership which are secured by any of the assets described on Exhibit 3.1 shall be distributed as follows:

- A. The first \$228,000 of such cash shall be distributed to P--- and ...”

N--- P--- obtained a loan on the assets. On September 5, 1985 N--- P--- distributed \$225,379.25 in cash to P--- pursuant to Section 4.3 of the Joint Venture Agreement. On September 5, 1985 P--- issued a check in the same amount to petitioner. This payment was shown on the books of both entities as a reduction in petitioner's investment in P---.

The auditor regarded the series of transactions as a sale of assets by petitioner to P---. The auditor calculated a ratio of the book value of taxable assets transferred to book value of total assets transferred. Taxable assets were tooling, machinery, equipment, furniture and fixtures. Non-taxable assets were vehicles and leasehold improvements. This ratio was 93.12% taxable. This ratio was multiplied times the sale proceeds of \$234,438 to arrive at the taxable amount in the original audit. The reaudit adjustment corrected the proceeds of the sale to \$225,379.75 which reduced the amount subject to tax in the reaudit.

Petitioner contends that the transfer of the assets was a contribution to the capital of P--- and that the payment from P--- to petitioner was a dividend which is not subject to tax. Petitioner cited Cal Metal Corp. v. State Board of Equalization, 161 Cal.App.3d 579.

Analysis and Conclusions

Section 6051 of the Revenue and Taxation Code imposes a sales tax on retailers based on the gross receipts from the retail sale of tangible personal property. Section 6006 defines "sale" to include any transfer of title to or possession of tangible personal property for a consideration. The question here is whether petitioner received consideration for its transfer of assets to Plastar.

The transfer of assets to a commencing corporation is not regarded as a sale unless the transferor receives consideration in the form of cash, notes, or an assumption of indebtedness (see Sales and Use Tax Regulation 1595, Subdivision (b)(4)). See also Business Taxes Law Guide [BTLG] Annotation 495.0090, (4/19/67). Similarly, dividends in kind are not regarded as a sale because there is no consideration. See BTLG, Annotation 495.0725 (7/22/76).

Here there is no dispute as to the receipt of cash by petitioner from P---. The dispute regards the nature of this payment: was it a dividend or consideration for the property transferred? I conclude that it was consideration for the property transferred. The amount is equivalent to the book value of the property. The payment was made within a few days of the transfer of the property. The final result is that petitioner has cash and P--- has the property. The joint venture agreement was structured so that the payment could be made in this fashion. Since there is consideration the transfer was a sale and that sale was subject to sales tax.

The cases cited by petitioner are distinguishable. Both deal with transfers to subsidiaries or partnerships where the transferee assumed liabilities of the transferor as a condition of the transfer of the property. The case here is similar to Industrial Asphalt, Inc. and Huntrix, Inc. v. State Board of Equalization, LASC C696414 in which there is no final decision yet. In that case the Board held that tax applied under almost identical conditions.

Recommendation

Redetermine in accordance with the reaudit report dated June 1, 1989.

H. L. Cohen, Senior Staff Counsel

9-16-91
Date