

Audit Manual

Chapter 10

OCCASIONAL SALES — SALE OF A BUSINESS

Business Tax and Fee Division
*California Department of
Tax and Fee Administration*

This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda. Please contact any California Department of Tax and Fee Administration office if there are concerns regarding any section of this publication.

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OCCASIONAL SALES — SALE OF A BUSINESS

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INTRODUCTION 1001.00

GENERAL 1001.05

This chapter is planned to aid the field auditor in resolving many of the varied and complex problems that arise as a result of an “occasional sale” or the sale of a business. The auditor may encounter situations that are not fully covered in this chapter. If the auditor is unable to reach a decision about the taxable status of the transactions in question after reviewing the following material, the auditor should consult his or her supervisor.

OCCASIONAL SALES 1001.10

Occasional sales as defined in Section 6006.5 of the Revenue and Taxation Code are exempt under Section 6367. In addition, transfers of tangible personal property to capital of a commencing or existing partnerships, joint ventures, limited liability companies (LLCs), and corporations, under the following conditions, are not in exchange for an interest having measurable value and are not subject to tax:

- a) To a commencing partnership or joint venture solely in exchange for an ownership interest in the partnership or joint venture.
- b) To an existing partnership or joint venture solely in exchange for an increased ownership interest, or the enhancement of the value of the existing ownership interest.
- c) To a commencing corporation or LLC solely in exchange for shares of the first issue of stock of the corporation or for a first issuance of an interest in the commencing LLC.
- d) To an existing corporation or LLC, if no shares of stock, interest, or other consideration is received, even though the value of the shares or interest already held by the person contributing the property is enhanced.

If a transfer is an occasional sale under Section 6006.5 and exempt under Section 6367, the auditor need not be concerned about whether it is nontaxable as a contribution. If the transaction is nontaxable as a contribution, the auditor need not be concerned whether the requirements of Section 6006.5, 6281 or 6367 are met.

The sale or purchase of a shareholder’s shares of stock of a corporation is not a sale of tangible personal property and is not subject to tax. The sale or purchase of a partner’s partnership interest in a general partnership or limited partnership or limited liability partnership, where the transfer of the interest does not cause or result in a dissolution of the partnership, is not a sale or purchase of tangible personal property and is not subject to tax. The sale or purchase of a member’s membership interest in a limited liability company, where the transfer of the membership interest does not cause or result in a dissolution of the limited liability company, is not a sale or

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purchase of tangible personal property and is not subject to tax.

DEFINITIONS

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- a) **Bulk Sale** — Sale of a business for a lump sum with no breakdown of the selling price of each asset or group of assets sold.
- b) **Commencing Corporation** — One that for the first time in its corporate life is issuing stock.
- c) **Commencing Partnership** — One that is new and did not exist before.
- d) **Going Concern** — Business that is currently operating and will continue to operate in the future.
- e) **Joint Venture** — A form of partnership of limited duration generally for a single transaction or specific project. The main difference between the joint venture and other partnerships is that a joint venture generally dissolves when the project is completed.
- f) **Merger** — The combination of entities that occurs when one or more entities are absorbed into one entity with that one entity continuing in existence. In a statutory merger, the merger and transfer of assets and liabilities occur pursuant to state law authorizing mergers. The disappearing entity(s) transfer their assets and liabilities to the surviving entity.
- g) **Number, Scope and Character of Sales.**
 - **Number** — More than two sales, including the one in question, in any 12-month period (not calendar year).
 - **Scope** — The extent of the sales measured by their frequency or dollar volume.
 - **Character** — Similarity in type and value giving effect to the relationship of taxpayer's regular business operations.
- h) **Occasional Sale** — A transaction that falls within the provision of Section 6006.5.
- i) **Occasional Seller** — Any person engaged in an activity not requiring a seller's permit, but making occasional sales of tangible personal property.
- j) **Partnership** — Is an association of two or more persons to carry on as co-owners of a business for profit.
- k) **Person** — Includes any individual, firm, partnership, joint venture, limited liability company (LLC), association, social club, fraternal organization, corporation, estate, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of this state, or any other group or combination acting as a unit.
- l) **Real or Ultimate Ownership** — Stockholders, bondholders, partners, members of an LLC or other persons holding an ownership interest in the corporation or other entity.
- m) **Reorganization** — Includes major changes in the financial structure of a group of related corporations resulting in alterations in the rights and interests of owners and security holders; usually involves a recapitalization or merger.
- n) **Seller** — Any person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of tax.
- o) **Statutory Merger** — When one or more entities are merged into another entity pursuant to Sections 1100–1305, 6010–6022, or 15678.1–15678.9 of the California Corporations Code,

or similar laws of this and other states.

DEFINITIONS

(CONT.) 1001.15

- p) **Substantially All** — 80 percent or more of the total tangible personal property held or used by a retailer in the course of an activity or activities for which he or she is required to hold a seller's permit would be required to hold a seller's permit if the activities were conducted in this state, including tangible personal property located outside this state.
- q) **Substantially Similar Ownership** — Ownership directly or indirectly of 80 percent or more of the total tangible personal property both before and after the transaction.

KINDS OF OCCASIONAL SALES

1001.20

Occasional sales fall into several general categories.

- Sales by persons not defined as sellers as defined in the Sales and Use Tax Law.
- Sales by occasional sellers.
- Sales of businesses meeting the exemption requirements of Section 6367 as defined in Section 6006.5(b).
- Sales of vehicles, mobilehomes, commercial coaches, vessels and aircraft meeting the requirements of Sections 6281 and 6285. (See Section 1001.40)

Examples of persons generally not requiring a seller's permit are:

- a) **Service enterprises in general:**
 - Accounting or law firms.
 - Launderers and cleaners.
 - Transportation firms.
- b) **Persons dealing exclusively in tangible personal property of a kind the retail sale of which is exempt by statute:**
 - Bakeries.
 - Dairy products.
 - Food processors.
- c) **Persons who grow and sell hay exclusively to beef cattle feed lots or dairies or through farmer cooperatives.**
- d) **Persons selling tangible personal property exclusively in the following types of transactions:**
 - Persons whose sales are exclusively in interstate or foreign commerce.
 - Persons whose sales consist solely of feed for food animals or animals held for resale.

However, operators of any of the foregoing activities described in (a) (b) or (c) do require seller's permits if they make sales of sufficient number, scope and character, e.g., dish rags, used fork lifts, non-food drinks, etc. For other sales by persons described in (d), see Section 1002.25.

DETERMINATION OF NUMBER OF SALES**1001.30**

More than two sales of tangible personal property for substantial amounts during any 12-month period (not calendar year) requires the holding of a seller's permit. Sales of tangible personal property are only included in determining whether a person has made more than two sales during a 12-month period if the tangible personal property is of a kind the gross receipts from the retail sale of which are taxable, whether or not ever sold at retail by that person. Transactions excluded from the definition of "sale" by the Revenue and Taxation Code are not considered when determining whether the holding of a seller's permit is required. In determining whether a person has made more than two sales during a 12-month period, the following types of sales are excluded:

- a) Trade-ins made incidental to a nonselling activity. For example, an accountant trading in an old copier for a new one.
- b) Sales made by an auctioneer on behalf of the person (auctioneer is the retailer and liable for the tax not the person.)
- c) Sales of horses through claiming races (racing association is the retailer and liable for the tax not the person owning the horse.)
- d) Sales of vehicles, vessels or aircraft, exempt from the sales tax by Sections 6282 and 6283, but subject to use tax imposed on the purchaser.

For example, a person engaged in a business which does not require the holding of a seller's permit is not liable for sales tax measured by the gross receipts from a retail sale of a piece of equipment used in the conduct of the business, even though that person may have made a series of trade-ins of old for new equipment. The sale of the equipment in question is not regarded as one of a series of sales, nor has the equipment been used in a selling activity and thus, the sale is an occasional sale.

If, however, in the example above, in addition to the equipment sale in question, two or more sales of substantial amounts have been made or are made in a period of 12 months, regardless of whether the other sales were at retail, for resale, or exempt from tax (for example, a sale in interstate commerce), the first two sales are regarded as occasional sales, but the third sale and subsequent sales, made within any 12 month period which resulted in the requirement to hold a permit, are subject to tax, unless otherwise exempt.

In determining whether the sales are for "substantial" amounts, the auditor should consider all the facts of each situation. The Board of Equalization has considered the issue of what constitutes sales in substantial amounts in the Memorandum Opinion of Pratt North Plaza Associates (10/28/93). The Board of Equalization concluded that a sale of \$400 is a substantial amount for the purposes of Regulation 1595, and the Board of Equalization specifically did not address the issue whether sales in amounts less than \$400 are substantial. Until otherwise directed, any sale of \$400 or more clearly counts as a sale for a substantial amount, and sales less than \$400 may also be considered substantial. Auditors should consult with their supervisor if any questions arise in determining whether a sale of tangible personal property is a sale for a "substantial" amount.

MUST QUALIFY IN EACH 12-MONTH PERIOD**1001.35**

If a seller qualifies as a retailer in one 12-month period, he must also qualify in subsequent 12-month periods if we are to assert the tax on sales made during subsequent periods. For example:

An examination of an occasional seller reveals the following sales (each of which was “substantial” as explained in Regulation 1595):

a)	January 3, 1995	Occasional sale
b)	September 16, 1995	Occasional sale
c)	September 8, 1996	Occasional sale
d)	March 8, 1997	Occasional sale
e)	July 17, 1997	Not occasional sale
f)	November 10, 1997	Not occasional sale
g)	August 11, 1998	Occasional sale
h)	December 12, 1998	Occasional sale
i)	September 8, 1999	Occasional sale
j)	December 9, 1999	Not occasional sale

Sales (a) and (b) are occasional sales since they were the first two sales made by the service enterprise.

Sale (c) is an occasional sale since it is only the second sale in a series of sales commencing within the prior 12 months, on September 16, 1995. The January 3, 1995 sale is not relevant since it occurred more than twelve months prior to sale (c).

Sale (d) is an occasional sale since it is only the second sale in the series of sales commencing within the prior 12 months, on September 8, 1996.

Sale (e) is not an occasional sale since it is the third sale in the series of sales commencing on September 8, 1996, which is less than 12 months prior to the sale.

Sale (f) is not an occasional sale since it is the third sale in the series of sales commencing on March 8, 1997, which is less than 12 months prior to the sale.

Sale (g) is an occasional sale since it is only the second sale in the series of sales commencing within the prior 12 months, on November 10, 1997.

Sale (h) is an occasional sale since it is only the second sale in the series of sales commencing within the prior 12 months, on August 11, 1998.

Sale (i) is an occasional sale since it is only the second sale in the series of sales commencing within the prior 12 months, on December 12, 1998.

Sale (j) is not an occasional sale since it is the third sale in the series of sales commencing on December 12, 1998, which is less than 12 months prior to the sale.

SALES OF RETAILER'S PERSONAL PROPERTY

1001.37

A sale of personal property not held or used in the course of activities of a person holding a seller's permit (or who would hold a seller's permit if the person's activities were conducted in this state) is occasional.

Examples:

- A restaurant owner also owns a dairy farm. He or she sells the farm along with livestock and farm and dairy equipment.
- A pharmacy owner sells his or her home furnishings, equipment and appliances.

**VEHICLES, MOBILEHOMES, COMMERCIAL COACHES,
VESSELS AND AIRCRAFT OCCASIONAL SALES**

1001.40

Neither sales nor use tax applies to the sale or use of vehicles required to be registered with the Department of Motor Vehicles, nor to off-highway vehicles subject to identification under Division 16.5 of the Vehicle Code, nor to mobilehomes and commercial coaches required to be registered with the Department of Housing and Community Development, nor to vessels or aircraft, providing:

- a) Such property is included in a transfer of all, or substantially all, the property held or used in the course of business activities of the person selling the property and the real or ultimate ownership of the property after the transfer is substantially similar to that which existed before such transfer; or
- b) The sale or transfer qualifies for the family exemption provided by Section 6285. Claimants of this exemption must submit satisfactory evidence of qualifying relationship to the Department of Motor Vehicles.

SALES BY GOING CONCERNS 1002.00

GENERAL 1002.05

- a) When taxable:
 - All sales of property held or used by a seller engaged in an activity for which a seller's permit is required.
 - Sales of property not exempt from tax held or used by a seller engaged in an activity for which a seller's permit is not required by reason of the nature of use, not kind of property or because all sales are sales in interstate or foreign commerce. (See Section 1002.25)
- b) When exempt or not subject to tax:
 - The property was not held or used in an activity for which a seller's permit was required, or
 - The sale was not one of a series of sales sufficient in number, scope and character to constitute an activity requiring a seller's permit (See Section 1001.35), or
 - The transaction was a transfer of tangible personal property to the capital to a partnership, joint venture, limited liability company or corporation without consideration. (See Section 1001.10)

SALES OF ASSETS BY CERTAIN PERMITTEES MAY BE OCCASIONAL 1002.10

Sellers whose business activities include both the sale of taxable tangible personal property and the sale of services or personal property exempted by statute will not be required to pay tax on the sale of property held or used exclusively in that segment of their business which does not require the holding of a seller's permit, unless the sales are of sufficient number, scope and character to qualify them as retailers of the assets sold.

Examples of permittees in this group are:

- A hotel that furnishes meals, beverages and lodgings sells its hotel beds.
- A theater that operates a snack bar sells its theater seats.

LOCATION OF ASSET SOLD MAY DETERMINE TAXABLE STATUS 1002.15

Where two activities, one requiring a seller's permit, the other not, are carried on at the same premises, the location of the asset sold may best determine its taxable status. For example:

- Sale of a television set by a hotel if located in a guestroom, hotel lobby, writing room, etc., would be occasional. If located in the bar, coffee shop or dining room, activities that require a seller's permit, it would be taxable.
- The sale of a shuffleboard or jukebox located in the bowling alley portion of a combination bowling alley and cafe would be occasional; if located in the restaurant, the sale would be taxable.

However, if the assets of the activity not requiring a seller's permit are partially used in support of the activity requiring a seller's permit, the sale of the assets should be treated as a taxable transaction in its entirety without regard to the physical location of the assets. For example:

- Sale of general office equipment used in the management of all portions of a bowling alley.
- The sale of tables and chairs located directly behind the bowling area that are used for bowler viewing and/or eating and drinking.

The selling price of the assets is not prorated between taxable and nontaxable use.

**SALES OF PROPERTY BY PERSON NOT REQUIRED
TO HOLD SELLER'S PERMIT BECAUSE OF NATURE OR USE**

1002.25

A single retail sale by a person not required to hold a seller's permit because of nature of use or engaged exclusively in the business of selling property exempted by nature of its use rather than its kind or nature of sale, i.e. interstate or foreign commerce, is not an occasional sale.

Example:

- The sale of a forklift used exclusively to load feed for cattle, chickens, or other food animals, is subject to the tax. Animal feed, as such, is not exempt from sales tax, but feed sold for food animals is exempt from the tax.
- Sale of a saw by sawmill not required to hold a seller's permit because all its sales are made exclusively in interstate or foreign commerce.
- However, a sale of property other than hay by a producer of hay may be an occasional sale under Section 6006.5(c).

SALE OF BUILDINGS AND MINERALS

1002.30

The sale of buildings or minerals or the like affixed to land is taxable as a sale of tangible personal property when, pursuant to the contract of sale or agreement of sale, the seller is to sever the buildings or minerals or like from the land. When the purchaser is to sever the building or mineral or like affixed to land pursuant to the contract of sale, the sale is not taxable as a sale of tangible personal property.

For example:

- Earth Company is selling rock and dirt to Pool Company. As required by the sales contract, Earth Company must sever the rock and dirt from its land prior to the sale. This is a taxable sale of personal property since the seller severed the rock and dirt pursuant to the contract of sale. However, if Earth Company allowed Pool Company to sever the rock and dirt from Earth Company's land, the sale is not taxable as a sale of tangible personal property.
- The sale of a building affixed to land owned by the seller is not taxable as a sale of tangible personal property if the purchaser severs the building. However, if the seller severs the building, the sale is a sale of tangible personal property and subject to tax. (See next section for fixtures, machinery or equipment that are affixed to the building being sold.)

See Regulation 1596, "Buildings and Other Property Affixed to Realty," for the application of tax to sales of mobilehomes and timber affixed to realty.

**TRANSFERS IN PLACE OF AFFIXED FIXTURES,
MACHINERY, EQUIPMENT OR DRAPERIES****1002.35**

Auditors must ensure that the fixtures, machinery, or equipment are affixed, actually or constructively, to the real property before using this section's analysis to determine whether tangible personal property is sold. If the fixtures, machinery, or equipment is not attached to the realty, the transaction is a sale of tangible personal property.

Transfer with concurrent sale of land or building to purchaser. (Reg. 1596(a))

The transfer in place of fixtures, machinery, equipment or draperies affixed to land and/or buildings, together with the transfer of the land and/or buildings to the purchaser of the fixtures, machinery, equipment or draperies, is a sale of tangible personal property if the building and/or land is to be severed from the realty by the seller, but is not a sale of tangible personal property, but instead is a transfer of real property not subject to sales tax, if the building and/or land is not to be severed from the realty at all or is to be severed by the purchaser of the building and/or land with affixed fixtures, machinery, equipment and draperies.

For example:

- Grocery Store A sells the building with the fixtures, machinery and equipment that are affixed to the building to Grocery Store B. Grocery Store A owns the land and building. Grocery Store B will operate the fixtures, machinery and equipment in its current place, and as such, is not contemplating removal of the fixtures. Additionally, Grocery Store A is not contemplating the removal of the fixtures. Grocery Store A does not sever the building. The sale of the building would not be taxable as a sale of tangible personal property. Additionally, since the contract of sale does not contemplate removal of the fixtures by the seller or purchaser, the sale of the fixtures would not be taxable as a sale of personal property. Note: if the seller did sever the building, the sale of the building and fixtures would be taxable as a sale of tangible personal property since severing the building would be considered contemplating removal of the fixtures.

**Transfers without concurrent sale of land
or buildings to purchaser. (Reg. 1596(c) 1st sentence)**

Transfers in place of fixtures, machinery, equipment or draperies affixed to land or buildings, without the concurrent sale of the land or buildings to the purchaser of fixtures, machinery, equipment or draperies, is a sale of tangible personal property when removal of the fixtures, machinery, equipment or draperies by either the seller or the purchaser is contemplated by the contract of sale. However, there is no sale of tangible personal property when removal of such fixtures, machinery, equipment or draperies is not contemplated by the contract of sale. Transfers in place of fixtures, machinery, equipment or draperies affixed to land or buildings, with the concurrent sale of the land or buildings to a person other than the purchaser of fixtures, machinery, equipment or draperies, is a sale of tangible personal property when removal of the fixtures, machinery, equipment or draperies by either the seller or the purchaser is contemplated by the contract of sale. However, there is no sale of tangible personal property when removal of such fixtures, machinery, equipment or draperies is not contemplated by the contract of sale.

**TRANSFERS IN PLACE OF AFFIXED FIXTURES,
MACHINERY, EQUIPMENT OR DRAPERIES**

(CONT.) 1002.35

For example:

- Grocery Store A sells its fixtures, machinery and equipment that are affixed to the building to Grocery Store B. Grocery Store A retains ownership of the land and building. The land and building are leased to Grocery Store B who will continue to operate the fixtures, machinery and equipment in their current place. The contract for sale does not provide either Grocery Store A or Grocery Store B the right to remove the fixtures. Therefore, the sale by Grocery Store A of the “in-place” fixtures, machinery, and equipment affixed to a building to Grocery Store B would not be taxable as a sale of tangible personal property since the contract of sale does not contemplate the removal of the fixtures by either party.

Transfers by real property lessee (Reg. 1596(c) 2nd sentence)

The transfer in place of fixtures, machinery, equipment or draperies affixed to land or buildings by a lessee of land or buildings is a sale of tangible personal property, when the lessee of the land or buildings to which the items are affixed has the present right to remove the items, either as trade fixtures under Section 1019 of the Civil Code, or under the express terms of the lease.

In sales by the lessee of the land, an auditor’s first step is to obtain the land or building lease agreement to determine if a right to remove is expressed in the lease contract. Additionally, Civil Code Section 1019 provides that a tenant may remove from the demised premises, any time during the continuance of his/her term, anything affixed thereto for purposes of trade, manufacture, ornament, or domestic use, if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises.

For example:

- A real property lessee sells “in-place” fixtures, machinery and equipment affixed to land or a building. The real property lease contract provides that the lessee has the present right to remove the fixtures, machinery and equipment. This is a taxable sale of tangible personal property since the lessee has the present right to remove the fixtures.

Transfers by third party lessor. (Rev. & Tax. Code § 6016.3, Reg. 1660(d)(7))

The transfer in place of fixtures, machinery, equipment or draperies affixed to land or buildings by the lessor of the items, who is not the lessor of the land or buildings to which they are affixed and who has the right to remove them on breach or termination of the lease, is a sale of tangible personal property. If the lessor does not have the right to remove the affixed fixtures, machinery, equipment or draperies on breach or termination of the lease, the transfer of the fixtures, machinery, equipment or draperies is not a sale of tangible personal property, but is a sale of real property.

SALE OF FIXTURES AFTER THE DATE OF CLOSE-OUT

1002.40

If a sale of fixtures and equipment is not contemplated at the date of closeout, a subsequent single sale of the fixtures may be treated as an occasional sale. However, the single sale of fixtures and equipment after the date of closeout is taxable if either:

- a) The sale occurs within 60 days of the date of close-out and the taxpayer cannot establish that the sale was not contemplated at the time of close-out; or
- b) The sale takes place after 60 days but within one year of the close-out date, and
 - A contract of sale existed at the date of close-out, or
 - A lease with an option to buy exists, or
 - Arrangements are in existence evidencing a plan to sell the fixtures and equipment in due course.

Unless the taxpayer makes sales that would otherwise qualify him or her as a retailer, a sale will be considered exempt if it occurs over 12 months after the last prior sale. This is true even though there is a contract of sale or an option in existence at the closeout date.

MANUFACTURERS AND WHOLESALERS

1002.45

A manufacturer, wholesaler, or other person in the business of making sales for resale of tangible personal property of a kind the retail sale of which is subject to tax, whether or not the property is ever sold at retail or is suitable for sale at retail, is subject to tax measured by the gross receipts from any of the person's retail sales of tangible personal property.

TRANSFER OF ASSETS BY OTHERS 1003.00

SALES BY AN EXECUTOR, ADMINISTRATOR, ETC. 1003.05

Tangible personal property sold with the sale of a business is subject to the sales tax even though the business has been operated by an executor, administrator, etc.

SALE BY TRUSTEE IN BANKRUPTCY 1003.10

Sales by a trustee in bankruptcy are subject to the tax if made during the operation of the business of the debtor to the same extent as sales by other retailers.

With respect to bankruptcy liquidation sales, in *California State Board of Equalization v. Sierra Summit Inc.* (1989) 490 U.S. 844 [104 L.Ed.2d 910] the U.S. Supreme Court determined that the trustee in a bankruptcy case is not acting as a representative of the federal government, but is instead a representative of the debtor. The court decision goes on to say a liquidation sale by the trustee is a taxable sale for sales and use tax purposes. All taxable bankruptcy liquidation sales, by trustees or their representatives, occurring on or after June 13, 1989, will be subject to the Sierra Summit Inc. decision. See CPPM Chapter 7 for guidelines in determining if a particular liquidation sale is taxable.

SALES BY ASSIGNEES 1003.15

The sales tax does not apply to the transfers of tangible personal property to an assignee for the benefit of creditors. The tax does apply, however, to retail sales made by such assignee if he or she makes sales in liquidation or otherwise, sufficient in number, scope and character to require the holding of a seller's permit.

TRANSFER OF PROPERTY TO A MORTGAGEE (LENDER) 1003.20

Tax does not apply to the transfer of tangible personal property subject to a purchase money mortgage or security interest from the purchaser-borrower to the seller-lender when the only consideration received by the borrower is cancellation of the unpaid balance of the purchase price.

Tax applies to the transfer of tangible personal property subject to a non-money mortgage or security interest from the borrower to a lender who was not the seller. The measure of tax is the amount by which the borrower's obligation was canceled plus any other consideration.

Tax does not apply to transfers of property as a result of the rescission of an original agreement or contract. The purpose of rescission is to terminate further liability under the contract and to restore the parties to their former position. A rescission results even though payment of damages is required to accomplish this restoration.

A deduction for returned merchandise by the original seller is not available under all of the circumstances described above unless the requirements of Regulation 1655 have been met.

TRANSFER OF PROPERTY OF DEBTORS, DECEDENTS, ETC.

1003.25

Transfers of property by an insolvent seller to an assignee, receiver, or trustee in bankruptcy are not subject to the tax because there is no consideration for the transfer.

Transfers of property to administrators, executors, etc., of a decedent's estate by reason of death are not subject to the tax nor are the subsequent distributions of the property by such administrators, executors, etc., to the beneficiaries of the deceased. There is no consideration for these transfers which occur by operation of law.

TRANSFER OF PROPERTY TO RELATIVES AND OTHERS

1003.30

If a taxpayer makes a gift of assets used in a business for which a seller's permit is required, tax is due only to the extent of the liabilities that have been assumed by the donee; the liabilities assumed may be related to or secured by tangible personal property or other property (e.g., intangible, real, etc.), or unsecured. An example of a proration of the liabilities between taxable and nontaxable property transferred is as follows: (See Sections 1004.35 and 1005.10):

Example:

A father gives his business to his son who assumes all business liabilities:

Book value of tangible personal property acquired for use and not resale	\$20,000
Book value of total assets	\$50,000
Liabilities assumed by son	\$8,000

Measure of tax:

$$\left(\frac{\$ 20,000}{\$ 50,000} \right) \times \$ 8,000 = \$ 3,200$$

In the event the father has included inventory valued at \$30,000 in the gift, the taxable ratio of 40% would change to 25% and the measure of tax would be:

$$\left(\frac{\$ 20,000}{\$ 80,000} \right) \times \$ 8,000 = \$ 2,000$$

An exception to tax due on the liability assumed by the donee occurs when a person who is not in the business of selling vehicles, vessels or aircraft sells such an item to a family member. This exemption is provided in Section 6285. Family members include parents, grandparents, children and spouse.

**TRANSFERS OF NONCOMMUNITY PROPERTY
BETWEEN HUSBANDS AND WIVES**

1003.35

Consideration for transfers of noncommunity property between a husband and wife, described in dollars and cents or other measurement of value will be the measure of tax. Where the consideration is intangible, e.g., "in consideration of love and affection," etc., the transfer will be considered a gift pursuant to the provisions of Section 1003.30.

SINGLE SALE BY OUT-OF-STATE RETAILER

1003.40

A single sale in this state of tangible personal property by an out-of-state retailer will not qualify as an occasional sale unless the sale would have been an occasional sale had the seller's place of business been located in California.

For example:

A lumber retailer in Oregon has used dragline equipment in California that he or she sells to a California consumer with title passing in this state. The retailer has made a taxable retail sale.

SALE OF A BUSINESS**1004.00****WHEN SUBJECT TO THE TAX****1004.05**

The following types of sales are subject to tax unless they meet one of the criteria described in Section 1004.10 or are otherwise exempt.

- a) The tax applies to that portion of the gross receipts from the sale of an entire business which represents the selling price of tangible personal property held or used in an activity for which the seller is required to hold a seller's permit and acquired by the purchaser for use rather than resale.
- b) Same as in (a) except that the property sold was not used in an activity requiring the seller to hold a seller's permit. However, the sales made were sufficient in number, scope and character as to qualify the seller as a retailer of assets, or the seller was not required to hold a seller's permit because of the nature of use or property sold, or its sales were made exclusively in interstate or foreign commerce.
- c) Tax applies to any consideration received for the transfer of tangible personal property to partnerships, joint ventures, limited liability companies, or corporations except to the extent that the transfer is of substantially all property without a substantial change in ownership. (See Section 1004.10(a))

Section 6367 exempts any transfer of all or substantially all of the property held or used in an activity requiring a seller's permit if, after the transfer, the real or ultimate ownership thereof remains substantially similar.

WHEN NOT TAXABLE**1004.10**

- a) Tax does not apply to transfers of all or substantially all the property held or used in an activity for which a seller's permit is required, (or for vehicles, mobile homes and commercial coaches required to be registered under the Vehicle Code or Health and Safety Code, and vessels and aircraft held or used in the course of the seller's business activities), provided that after the transfer the real or ultimate ownership of the property is substantially unchanged. Stockholders, bondholders, partners, LLC members or other persons holding an interest in the corporation or other entity are regarded as having the "real or ultimate ownership."
- b) Tax does not apply to transfers of tangible personal property to partnerships, joint ventures, limited liability companies, or corporations to the extent that the transfers constitute contributions of capital with no consideration received by the transferee. (See Section 1001.10)
- c) Tax does not apply to a corporation's transfer of property to a surviving or new corporation pursuant to a statutory merger under California law or similar laws of other states. A statutory merger is not a sale but is instead a transfer by operation of law. Any related transfer of assets is between the corporations, not with the shareholders. Accordingly, if shareholders receive cash or shares of the new or surviving corporation when they surrender their old shares, there has not been a sale of tangible personal property.
- d) Tax does not apply to the sale of property not held or used by the seller in the course of activities for which the seller is required to hold a seller's permit and not otherwise taxable solely because of the nature of activities carried on in an entirely separate endeavor. For example, a hospital can have an exempt occasional sale of its assets used in the rendering of medical and nursing services provided the assets were not used in its activities requiring a seller's permit, such as the activities of the pharmacy and cafeteria (*Ontario Community Foundation, Inc., et al. v. State Board of Equalization* (1984) 35 Cal.3d 811). The test is whether sales are made in an entirely separate endeavor from the selling enterprise.

WHEN NOT TAXABLE

(CONT.) 1004.10

Whether a taxpayer is engaged in entirely separate endeavors is determined on a case-by-case basis. The following points should be considered in deciding whether a taxpayer's endeavors are separate for these purposes. When a taxpayer's endeavors reflect all of the following points, they would be regarded as separate endeavors. The fewer of the points satisfied, the greater the burden on the taxpayer to establish that the endeavors are, in fact, entirely separate endeavors for these purposes. (See also Section 1002.10)

- 1) Each "division" has a completely separate set of books, including journal and general ledgers.
- 2) Each set of books is separately maintained.
- 3) Separate bank accounts are maintained.
- 4) Employees are active in only one "division."
- 5) The "divisions" are housed in separate buildings.
- 6) Each "division" has its own fixed assets, including automotive and office equipment which is not used interchangeably.

METHOD OF DETERMINING IF OWNERSHIP CHANGES SUBSTANTIALLY 1004.15

The following is the method used in determining if there is more than a 20 percent change in ownership where a partnership transfers all of its assets to a corporation.

	Partnership	Corporation	Interests Common Before and After Incorporation
A	40 %	33 1/3 %	33 1/3 %
B	40 %	33 1/3 %	33 1/3 %
C	20 %	33 1/3 %	20 %
	100 %	100 %	86 2/3 %

Partner A owns one-third interest in the corporation and owned at least one-third interest in the partnership. The same is true of partner B. Partner C owned 20 percent interest in the partnership and 33-1/3 percent in the corporation. Thus, the interests that are common in the partnership and the corporation are A 33-1/3 percent, B 33-1/3 percent, and C 20 percent; a total of 86-2/3 percent. There is less than 20 percent change in ownership in this example.

This means that the real or ultimate ownership is "substantially similar" to that which existed before the transfer, and therefore, the transfer of tangible personal property would not be a taxable transaction.

EXAMPLES OF TAXABLE AND NONTAXABLE TRANSFERS

1004.20

- a) A and B each own 50 percent of partnership AB. Some partnership property is transferred by the partnership solely for stock in commencing corporations Y and Z. A and B each own 50 percent of corporation Y and corporation Z.

Answer: Nontaxable. Transfer of property solely for stock in commencing corporation.

- b) Six months after the formation of the corporations, the partnership sells all of its packaging equipment, which represents less than 80% of the tangible personal property used in the business, for cash.

Answer: Taxable. Sale is by one entity to one or more other entities.

- c) One year after transaction (b) the partnership sold its remaining assets to corporation Y and Z for cash.

Answer: Nontaxable. A transfer of all the assets of a business — the ultimate ownership remaining unchanged.

BULK SALES OF BUSINESSES

(SALES PRICE OF TANGIBLE PERSONAL PROPERTY NOT SPECIFIED) 1004.25

In sales of this type, it will be necessary for the auditor to determine the sales price of the tangible personal property transferred. Listed below are the methods the auditor should use to determine the sales price of the property transferred:

- a) Determine the book value.

In some instances, book value may not represent true value of tangible personal property or other assets transferred. Accelerated depreciation may have been used whereas the straight-line method would have reflected a more accurate value. Unless otherwise substantiated, it will be presumed that when a sale of a business is made for an amount in excess of the depreciated book value, the parties to the contract bargained to sell and purchase all assets at the pro rata increased value.

- b) Convert the county tax assessor's appraisal to actual value.

As the percentage of appraisal varies in the several counties of the state, the auditor should, if possible, determine the percentage used by the local assessor.

- c) Independent appraisal.

- d) Taxpayer's estimate.

The auditor should, if at all possible, use two or more of the above methods in order to check the results of one method against the other.

DETERMINING VALUE OF ASSETS — USE OF IRS FORMS 8594 AND 4797 1004.27

The Internal Revenue Service (IRS) requires taxpayers to file Form 8594, Asset Acquisition Statement, when there is a transfer in the ownership of a business. IRS Form 4797, Sales of Business Property, is required when there is a sale of a group of assets that makes up a trade or business. The information contained on these forms may help in determining the value of fixtures and equipment when a business is sold. Copies of these forms can be found on the IRS website: www.irs.gov.

Bulk Sale of a Business - IRS Form 8594

IRS Regulation section 1.1060-1 (e)(1)(ii) and section 338 require that the buyer and the seller in an applicable asset acquisition, each report on Form 8594 the amount of consideration in the transaction and specific information about the allocation of consideration among the assets transferred.

Both the seller and the buyer of a group of assets that make up a trade or business are required to file Form 8594 to report such sales if goodwill or going concern value attaches to, or could attach to, the assets sold or transferred and if the buyer's basis in the assets is determined only by the amount paid for the assets. The IRS requires both the buyer and the seller of the assets to prepare and attach the form to their Federal Income Tax Return.

Generally, Form 8594 would be attached to the Federal Income Tax Return for the year in which the sale occurred. However, Part III, Supplemental Statement, of Form 8594 must be filed if the buyer or seller is amending a previously filed form because of an increase or decrease in the buyer's cost of the assets or the amount realized by the seller.

The information that must be reported on Form 8594 includes the following:

1. The name, address, and taxpayer identification number of the buyer and the seller.
2. The purchase date.
3. The total consideration for the assets.
4. The amount of consideration allocated to each class of assets and the aggregate fair market value of assets in each class.
5. A statement as to whether the buyer and seller agreed upon the fair market value of the assets in the contract of sale.
6. The useful life of each class III intangible and amortizable asset. (Class III assets are all tangible and non-tangible assets. Examples of class III assets include furniture and fixtures, land, buildings, equipment, and accounts receivable.)
7. A statement as to whether, in connection with the acquisition of the group of assets, the buyer also obtained a license, a covenant not to compete, or entered into a lease agreement, an employment contract, a management contract, or similar arrangement between the buyer and the seller (or the managers, directors, owners, or employees of the seller).

Exceptions to the requirement for filing IRS Form 8594 include the following:

1. The acquisition is not an applicable asset acquisition. An applicable asset acquisition includes both a direct and indirect transfer of a group of assets, such as a sale of a business, if goodwill or going concern value attaches to, or could attach to, the assets, and the buyer's basis in the assets is wholly determined by the amount paid for the assets.
2. A group of assets that makes up a trade or business is exchanged for like-kind property in a transaction to which Internal Revenue Code (IRC) §1.1031(j)-1 applies. As a general rule, the application of IRC §1031 requires a property-by-property comparison for computing the gain recognized, and the basis of property received in a like-kind exchange.
3. A partnership interest is transferred.

Sale of Business Property - IRS Form 4797

IRS Form 4797 is used to report the sale or exchange of property used in a trade or business; depreciable and amortizable property; oil, gas, geothermal, or other mineral properties; and IRC section 126 (certain cost-sharing payments) property. Form 4797 is also used to report the following:

1. The involuntary conversion of property used in a trade or business and the capital assets held in connection with a trade or business or a transaction entered into for profit, as well as the disposition of non-capital assets other than inventory or property held primarily for sale to customers in the ordinary course of a trade or business.
2. The disposition of capital assets not reported on IRS Schedule D.
3. The recapture of IRC section 179 expense deductions for partners and S Corporation shareholders from property dispositions by partnerships and S corporations. The deduction allows for up to the entire cost of certain depreciable business assets, other than real estate, in the year purchased, which may be used as an alternative to depreciating the asset over its useful life. Taxpayers cannot use the IRC section 179 deduction to the extent that it would cause them to report a loss from their business.
4. The computation of recaptured amounts under IRC section 179 and IRC section 280F(b)(2), when the business use of section 179 or listed property drops to 50% or less (IRC section 179 -The limitation on depreciation for luxury automobiles; limitation where certain property is used for personal purposes).

Requesting Copies of Forms

Staff should request a copy of IRS Forms 8594 and Form 4797 from the taxpayer to determine the sales price of the tangible personal property when it is either sold or transferred under the above conditions. If the information is not readily available from the taxpayer, staff may request the information through Form CDTF-33-B, Request for Federal Tax Information. Requests should be directed to the Business Tax and Fee Division, Chief, Tax Policy Bureau, MIC: 92. After the pertinent information has been obtained from the return it should be returned immediately to the designated custodian of records and sent back to the Chief, Tax Policy Bureau. Staff should observe guidelines for use of confidential information as outlined in BEAM 7216.

BULK SALE OF A BUSINESS — CONDITIONAL SALES CONTRACT**1004.30**

In many instances, businesses are sold under a conditional sales contract. This is a method to secure payment of the entire purchase price by retaining title to the assets transferred.

When the auditor encounters this situation, he or she should consider the values of inventories and intangibles included in the balance of the conditional sales contract and determine the fair market value of the taxable tangible personal property transferred. The methods outlined in Section 1004.25 may be of aid in making this determination.

ASSUMPTION OF CONDITIONAL SALES CONTRACT

1004.32

The following example illustrates the proper method of determining the total consideration received from the sale of tangible personal property where the buyer assumes the remaining balance of a conditional sales contract:

A buys an item of tangible personal property, sales price \$3,500, from B under a contract whereby title remains in B until the sales price is paid (a conditional sales contract). A pays \$500 down and agrees to pay the balance of \$3,000 plus \$600 interest at \$100/month. After making six monthly payments, A wishes to sell his or her interest in the property to C. (It is assumed the transaction is not an occasional sale.)

B agrees to the transaction, and C takes over A's obligation under the contract giving A \$100 cash for A's "equity."

The measure of the tax is the amount of cash exchanged (\$100), if any, plus the amount of the obligation from which A was relieved. Since A could pay off the contract at any time during its term, his or her obligation is the amount of "principal" still owing plus any amount due to B for: (1) interest earned to date of payment, and (2) any "prepayment penalty" which would be assessed if the contract were, in fact, to be paid in full.

CONTRIBUTIONS TO CAPITAL OF A PARTNERSHIP OR JOINT VENTURE 1004.35

- a) The transfer of tangible personal property by an individual, partnership, joint venture, limited liability company, corporation, or other entity solely for a capital interest in a commencing partnership or joint venture, or a transfer by an existing partner for an increased partnership interest is not subject to tax. Since there is no measurable value in money of the capital interest at the time of the transfer to the commencing partnership and no consideration received in a subsequent transfer, the transaction is not a sale.

Examples of such transfers:

A, who operates a business with \$50,000 assets and no liabilities, forms partnership AB with B. A contributes \$50,000 assets, and B contributes \$50,000 cash.

Partnership AB is a going concern. B, a partner, and a seller in his or her own capacity, contributes an additional \$10,000 in assets to the partnership thereby increasing his or her percentage of ownership interest in the partnership. No consideration is received by B.

- b) However, tax applies to the extent consideration is received; i.e., assumption of liabilities, cash, notes, etc. The measure of tax shall be computed using the following formula:

$$\left(\frac{\text{Selling Price of the Tangible Personal Property Transferred for Use, Not Resale}}{\text{Selling Price of All Property Transferred}} \right) \times \text{All Consideration} = \text{Taxable Measure}$$

Selling Price is presumed to be book value. Goodwill, patents, and other intangibles may be transferred and accounted for in the formula if these assets existed on the books of the transferor prior to their transfer to the commencing partnership. However, the transferor may establish that the selling price was a price other than book value, such as appraised value, for all assets transferred.

All Consideration includes cash, notes, or assumption of indebtedness.

ASSUMPTION OF CONDITIONAL SALES CONTRACT

(CONT.) 1004.32

Example:

A, an individual, transfers to B, a commencing partnership, the following:

Equipment and Fixtures	\$20,000
Real Property	<u>\$30,000</u>
Total Assets Transferred	<u>\$50,000</u>

A receives from B, the partnership, a partnership interest and consideration consisting of an assumption of liabilities of \$10,000.

The measure of tax is computed as follows:

$$\left(\frac{\$ 20,000}{\$ 50,000} \right) \times \$ 10,000 = \$ 4,000$$

c) Other examples of how the tax applies to transfers to partnerships:

- (1) A operates a business with \$50,000 assets, \$10,000 of which are tangible personal property not purchased for resale, and \$25,000 in liabilities. A contributes the assets to the partnership that in turn assumes the liabilities. A then receives \$12,500 cash from B for one-half interest in the partnership.

Computation of A's taxable measure:

Liabilities assumed	\$25,000
Cash received by A	\$12,500
Total consideration	\$37,500

$$\left(\frac{\$ 10,000}{\$ 50,000} \right) \times \$ 37,500 = \$ 7,500$$

- (2) A operates a business with \$50,000 assets, \$10,000 of which are fixtures and equipment and the remainder of which is inventory or property other than tangible personal property. A contributes assets to the commencing partnership B for which A receives \$25,000 from B for one-half interest in the partnership.

$$\left(\frac{\$ 10,000}{\$ 50,000} \right) \times \$ 25,000 = \$ 5,000$$

The measure of tax for the sale by A to the partnership is \$5,000.

TRANSFER OF PARTNERSHIP INTEREST

1004.40

- a) The sale by one partner of a partnership interest or the sales by one or more partners of all or a portion of their partnership interest is not subject to the tax unless the transfer causes or results in a dissolution of the partnership. On dissolution, there is a distribution of partnership assets pro rata, and the sale by the withdrawing partner of the partner's interest in tangible personal property distributed to him or her. The partner's sale of the distributed property, if held or used by the partner/seller in the course of activities for which the seller is required to hold a seller's permit or if the sale is one in a series of sales by the partner(s) qualifying him or her as a retailer, is a sale of tangible personal property subject to tax unless otherwise exempt.

Examples:

- 1) Partnership business is operated by A and B. B, who does not hold a seller's permit and has not made a series of sales sufficient in number, scope, and character to require the holding of a seller's permit, sells his or her partnership interest to A who continues as an individual. No taxable transaction: occasional sale.
 - 2) Partnership business is operated by A and B, who does not hold a seller's permit and has not made a series of sales sufficient in number, scope, and character to require the holding of a seller's permit. B sells his or her interest to C. The business continues to operate by partnership AC. No taxable transaction: occasional sale.
 - 3) Partnership business operated by A and B who holds a seller's permit. B sells his or her interest to C. If the transfer causes a dissolution of the partnership, B's transfer of distributed property to C is subject to tax. If the transfer does not cause a dissolution of the partnership, B's transfer to C is not subject to tax. The business continues as a partnership.
- b) Distributions of the assets of a partnership to partners upon dissolution are liquidating distributions and are not subject to the tax.
- c) Where a partnership distributes some of its assets in the form of a partial liquidation of the business, the tax does not apply, providing an entire segment of the business of the partnership is being liquidated. For example: A partnership operates a lumberyard and a hardware business. A decides to cease operating the lumberyard. If the assets used in the lumberyard are distributed free and clear of any liabilities to the partners in accordance with their interest in the partnership assets, the distribution is not subject to the tax.
- d) Sales of the assets of a partnership holding a seller's permit are taxable if sold before dissolution. If, however, the partnership is dissolved and all assets are distributed in kind to partners the distribution of the property would not be subject to the tax. If the partners in turn sold the assets, the sales may qualify as occasional sales.
- e) Joint Ventures. Upon dissolution of the joint venture, property transferred to the members will be considered a liquidating distribution and not subject to the tax in the same manner as a dissolution of a partnership.

Sale of a member's interest in the venture, which dissolves the venture, to the other members or another person will be considered occasional unless the member is a retailer by virtue of a series of sales or by requirements to hold a seller's permit.

TRANSFER OF PARTNERSHIP INTEREST

(CONT.) 1004.40

- f) Tenants in Common. Where a tenant in common transfers his or her interest in tangible personal property, the sale will be considered occasional unless the tenant is a retailer or becomes a retailer by the sale being one of a series of taxable sales.

Examples:

- 1) A sells one-fourth interest in a grain harvester to B.
- 2) X, Y and Z Water Districts jointly own trenching equipment. X sells its interest to either Y or Z Water Districts.
- g) Vehicles, Vessels and Aircraft. Transfers of vehicles, vessels and aircraft are never occasional sales and transfers of these items may be subject to use tax even though the sale of other assets may be exempt occasional sales.
- h) Tax applies to sales of an interest in an LLC and distributions of liquidating interests in an LLC in the same manner as it applies to sales of partnership interests and liquidating partnership distributions.

TRANSFER OF ASSETS IN PAYMENT OF PARTNERSHIP LOANS

1004.45

Upon dissolution of a partnership, assets transferred from one partner or partners to another partner or partners in payment of loans are not considered liquidating dividends. Any such transfer is subject to the tax unless exempt as an occasional sale.

CONTINGENT SALES PRICE

1004.50

Some sales of a business that include the sale of tangible personal property contain a contingent sales price. A sales price is subject to a “contingency” if there is some uncertainty as to the sales price, which will ultimately be resolved when one or more future events occur or fail to occur.

For example: The parties may agree to a contingent sales price for machinery by agreeing to a specific sales price for the machinery and also agreeing that the purchaser will pay a higher sales price if the machinery is able to exceed certain predetermined production levels over a specified period of time.

When there is a sale of a business that includes the sale of tangible personal property and the transaction contains a contingent sales price, the following guidelines should be used to determine the proper measure of tax, the period in which the sale should be reported, and whether the taxpayer will need to subsequently file an amended return or claim for refund.

Specific Price Agreed To

When the parties to a transaction have agreed to a specific price for the tangible personal property included in the taxable sale of a business, then that price should be used to determine the taxable measure to be reported for the period in which the sale occurs. In addition, when the parties have agreed to a contingent sales price for the sale of a business, but have also agreed to a specific price for the sale of taxable tangible personal property included in the sale, any subsequent adjustment to the total sales price of the business will **not** affect the specific sales price of the taxable tangible personal property, unless the adjustment actually relates to the value of the taxable tangible personal property.

CONTINGENT SALES PRICE**(CONT.) 1004.50****No Specific Price Agreed To**

In instances where there is a bulk sale of a business and the parties have not agreed to a specific price for the taxable tangible personal property, the parties have implicitly agreed to buy and sell the taxable tangible personal property at its current value, regardless of whether the total selling price for the business is fixed at the time of sale or is subject to a contingency. Therefore, when the parties agree to the sale of a business for a contingent sales price, but do not agree to a specific price for the taxable tangible personal property included in the sale, the taxable measure should be determined by following the procedures set forth in AM section 1004.25 for determining the sales price of tangible personal property included in a bulk sale.

To determine the sales price of taxable tangible personal property staff should look to one of four indicia of value:

- 1) Book value,
- 2) Appraised value for property tax purposes,
- 3) Value determined by an independent appraisal, and
- 4) Taxpayer's estimate.

Staff should then use at least one of the remaining three indicia to verify the accuracy of the value indicated by the first indicia. As a result, the value of the tangible personal property—and thus the measure of tax— will generally be equal to the book value of such property. The taxable measure from the bulk sale should be reported on the return for the period in which the sale occurred because the value of tangible personal property can be determined by reference to its book value at the time of the sale, and there should not be a need to subsequently file an amended return or claim for refund.

CORPORATIONS

1005.00

CONTRIBUTIONS TO COMMENCING CORPORATIONS

1005.05

Contributions of tangible personal property by any individual, partnership, joint stock company, limited liability company (LLC), or corporation to a commencing corporation solely in exchange for stock in the new corporation are not subject to the tax. If the contributor received any consideration for the transfer (e.g., the corporation assumed liabilities or issued notes or cash to the contributor), the transfer is subject to tax.

STOCK AND CONSIDERATION RECEIVED FOR ASSETS TRANSFERRED 1005.10

If a transfer of assets is made to a commencing corporation solely for first issue stock in the commencing corporation, there is no sale since the stock received by the transferor is not regarded as having measurable value at the time of the transfer. Thus, the stock is not considered gross receipts or consideration. If the transferor receives any consideration such as notes, cash, or the corporation's assumption of liabilities (even where the transferor also remains liable), the measure of tax shall be computed by the following formula:

$$\left(\frac{\text{Selling Price of the Tangible Personal Property Transferred for Use, Not Resale}}{\text{Selling Price of All Property Transferred}} \right) \times \text{All Consideration} = \text{Taxable Measure}$$

Selling Price is presumed to be book value of the assets transferred. Goodwill, patents, and other intangibles may be transferred and accounted for in the formula if these assets existed on the books of the transferor prior to their transfer to the commencing corporation. However, the transferor may establish that the selling price was a price other than book value, such as appraised value, for all assets transferred.

All Consideration means cash, notes, or assumption of indebtedness.

Example:

A transfers equipment with a book value of \$100,000 to B, a commencing corporation. B assumes liabilities of A in the amount of \$60,000. As the assumption of the liabilities by B constitutes consideration received by A, the tax will be computed as follows:

$$\left(\frac{\$ 100,000}{\$ 100,000} \right) \times \$ 60,000 = \$ 60,000 \text{ subject to tax}$$

The above example is, of course, a rather simple illustration of the formula. The following example will better illustrate situations that are commonly encountered by the field auditor:

A'S BALANCE SHEET AS OF 12-31-99			
Assets		Liabilities	
Cash	\$ 5,000	Accounts payable	\$ 14,500
A/C Receivable	13,000	Taxes payable	500
Inventory	25,000	Notes payable (secured by real property)	10,000
Furniture less depr.	5,500	Notes Payable (secured by personal property)	10,000
Motor Vehicle less depr.	6,000	Notes Payable (unsecured)	5,000
Machinery less depr	49,000	Total Liabilities	\$ 35,000
Buildings less depr.	15,000		
Land	5,000	Proprietorship	88,500
Total	\$ 123,500	Total	\$ 123,500

OCCASIONAL SALES — SALE OF A BUSINESS

STOCK AND CONSIDERATION RECEIVED FOR ASSETS TRANSFERRED

(CONT.) 1005.10

A transfers motor vehicles, machinery, inventory, and real estate to B, a commencing corporation, in exchange for stock and consideration of \$10,000 cash and an assumption of all of A's liabilities of \$35,000. The computation of the measure of tax will be as follows:

Assets Transferred *		Consideration Received	
Inventory	\$ 25,000	Cash ³	\$ 10,000
Motor vehicle ¹	6,000		
Machinery ²	49,000	Liabilities assumed ³	35,000
Real estate	20,000		
Total	\$ 100,000	Total	\$ 45,000

1. DMV will assess use tax at time of registration.
2. Tangible personal property not for resale.
3. Total consideration.

* book value presumed to reflect selling price.

Formula:

$$\left(\frac{\text{Selling Price of the Tangible Personal Property Transferred for Use, Not Resale}}{\text{Selling Price of All Property Transferred}} \right) \times \text{All Consideration} = \text{Taxable Measure}$$

$$\left(\frac{\$ 55,000}{\$ 100,000} \right) \times (\$ 10,000 + 35,000) = \$ 24,750 \text{ subject to tax}$$

The measure of tax for the transfer of the motor vehicle is \$2,700, (\$6,000 Motor Vehicle / \$100,000 Selling Price of All Property Transferred X \$45,000 All Consideration) and use tax measured by that amount shall be paid to the DMV. The measure of tax for the other tangible personal property transferred for use by the corporation is \$22,050.

EXCHANGE OF PROPERTY FOR RETURN OF STOCK

1005.15

Tangible personal property received by a stockholder in exchange for shares of stock which are then retired is a means of reducing the stated capital. Such transfers are not liquidating dividends and are therefore subject to the tax.

PRO RATA OR LIMITED DISTRIBUTION OF PROPERTY

1005.20

Where all the stockholders of a corporation receive a pro rata share of some of the assets of the corporation for a portion of the shares they hold and the shares relinquished are retired as a means of reducing capital, such distribution is a partial liquidation and is not subject to the tax.

TRANSFERS TO MORE THAN ONE ENTITY

1005.25

The simultaneous transfer of all or substantially all of the assets of a corporation to one or more wholly owned subsidiaries is an exempt occasional sale under Section 6376 as defined in Section 6006.5(b).

Example:

A corporation operates five service stations. Four new corporations are formed and the assets of each one of the stations are transferred to the new corporation in exchange for stock. After the transfer there would be one parent corporation and four wholly owned subsidiaries each owning and operating one service station.

MERGER AND REORGANIZATION¹**1005.30**

When a corporation is involved in a merger or reorganization, sales tax may or may not apply to the transfer of assets, depending on the manner in which the transfer is accomplished.

When Sales Tax May Apply:

- a) Transfers of assets of a constituent corporation pursuant to a corporate reorganization that does not qualify as a statutory merger under the California Corporations Code or similar laws of other states.
- b) Transfers of assets of a constituent corporation treated as a corporate reorganization under the Internal Revenue Code, even if there is no federal income tax liability.

When Sales Tax Does Not Apply:

Transfers of assets from a disappearing corporation to a surviving corporation pursuant to a statutory merger as set forth in Sections 1100–1305 of the California Corporations Code or similar laws of this and other states.

A merger pursuant to a statutory merger is exempt as an occasional sale (AM section 1004.10). The determination of whether a merger qualifies as a statutory merger is within the jurisdiction of the Secretary of State (SOS) and not the California Department of Tax and Fee Administration (CDTFA). Section 1103 of the California Corporations Code provides for filing the agreement with SOS. California statutory mergers are evidenced by a merger agreement that carries a filing stamp showing it has been filed as certified by SOS. The certified copy of the merger agreement issued by SOS may be accepted as proof that the merger agreement conforms to California's statutory requirements.

Procedures for Obtaining Certified Copy of a Merger Agreement

If evidence of the filing of a merger agreement is not available, the office should request a certified copy of the merger directly from SOS, and copy the Deputy Director, Field Operations Department on all correspondence. The request must be in writing by completing the form available at http://www.sos.ca.gov/business/pdf/be_ircform.pdf and mailing it to SOS using the address shown on the form. The fees for certified copies of merger agreements are listed on the form. The CDTFA's billing code (24000) must be indicated on the form.

SOS will mail the certified copies of the merger agreements to the requestor within eight to nine weeks of receiving the request. Alternatively, requests for certified copies of merger agreements may be made in person at the SOS office. The copies will be available for pick-up within five business days.

¹ These procedures apply only to statutory mergers pursuant to California law. The Audit and Information Section (MIC 44) should be consulted regarding procedures for obtaining a certified copy of a merger agreement from another state.