

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 061

June 27, 1958

### CORPORATE REORGANIZATIONS: STEP TRANSACTION

#### Syllabus:

The tax-free reorganization provisions of the Bank and Corporation Tax Law are not applicable as under the facts present the "step-transaction" doctrine is applicable.

X Inc. was organized to operate an automobile dealership. A, its sole stockholder, died in 1948 and his stock passed to B, his widow. In November, 1948 X Inc. transferred all its assets except the land and buildings to Y Co., a new corporation. On the same day B turned in 1/3 of her shares in X Inc. and received in all of the Y Co. stock. Seven days later B sold 51% of the Y Co. stock to C, the brother of A. Advice is requested as to whether under this factual situation there was a tax-free reorganization for purposes of the Bank and Corporation Tax Law.

Sections 23251 and 25036, in defining a reorganization involving the transfer of assets by one corporation to another, require that immediately after the transfer the transferor or its shareholders or both be in control of the corporation to which the assets are transferred. Sections 23251 and 25037 define control as meaning the ownership of at least 80% of the voting stock and at least 80% of all other classes of stock. If the first transfer is looked at alone, B was in control of Y Co. immediately after the transfer. However, seven days later that control was surrendered when she transferred 51% of Y Co's stock to C. The question raised is whether the transactions should be treated as separate transactions or as constituent steps of one integrated transaction so that the "step-transaction" doctrine applies. The fundamental test of the applicability of this doctrine is whether on a reasonable interpretation of objective facts the steps were so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series.

In the instant case there was a single pervading purpose toward which the several steps were directed. This purpose was to save the dealership franchise. It could be accomplished only by putting a qualified person, C, in control of the automobile business. The first transaction was insufficient to accomplish this and would have been meaningless without the further transfer of stock to C. Although there was no contractual writing or legal obligation on B, after acquiring all the stock of Y Co, to transfer 51% of the stock to C and although she became the real owner and was in control for one week, nevertheless,

an integral part of the reorganization contemplated the acquisition by a person other than transferor or its shareholders of more than 20% of the stock. Therefore, the two transactions were parts of one entire transaction, and the requisite control did not rest in the transferor or its shareholders. The result is that this was not a tax-free reorganization under the provisions of the Bank and Corporation Tax Law and any gain or loss to X Inc. and Y Co. must be reported.