

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 162

November 25, 1957

REORGANIZATION: "SUBSTANTIAL PORTION" OF BUSINESS OR PROPERTY UNDER SECTION 23251(a)

Syllabus:

The transfer by a corporation to a wholly owned subsidiary of an entire division or segment of its business, although the portion transferred is as small as approximately 20 percent of the entire California assets of the corporation, is a substantial portion of business or property for reorganization purposes under Section 23251(a) of the Bank and Corporation Tax Law.

X Co. purchased the assets of Y Co. in 1947 and operated them as a branch plant manufacturing furnaces under the Y Co. name. In February 1950 said assets were transferred to the A Co. in exchange for all of A Co.'s stock. The assets transferred to A Co. represented 4.75% of the total assets of X Co. and 16% of the California assets of X Co. On April 15, 1951, A Co. filed its first return and assessed itself a two year liability under Section 23222 of the Bank and Corporation Tax Law. A Co., in 1955, filed a claim for refund on the basis that the exchange in 1950 was a reorganization and it was not taxable as a commencing corporation. Advice is requested whether A Co. acquired a "substantial portion" of the parent company's business or property in the exchange.

Section 23251(a) provides that a reorganization occurs if a corporation transfers a substantial portion of its business or property to another corporation if immediately afterwards the transferor or its stockholders are in control of the corporation to which the assets were transferred. Section 23253 provides that in the type of reorganization under Section 23251(a) the net income of the transferor "from the business or property transferred" shall be taxed to the transferee. Since the law can only reach income which has its source in this State, the quoted portion of Section 23253 must refer to income arising from business or property in California which is transferred. Similarly, the same limitation must be read into Section 23251(a). In the Appeal of J. J. Newberry Realty Co. decided by the State Board of Equalization on March 29, 1949, the Board held, without inquiring into the extent of total assets owned by a foreign transferor, that a reorganization had occurred when California assets were transferred to another corporation owned by the same interests. In the opinion it was suggested that the word "California" must be read into the provisions of Section 23251.

Under the ruling of San Joaquin Ginning Co. v. McColgan, 20 C2d 254, in which the court interpreted the reorganization provisions of our law, we are required to give the term reorganization a liberal construction particularly if the transaction does not substantially change the continuity of interest. There

are no California cases which have defined the term "substantial portion", but in People v Ames, 61 CA2d 552, the court gave the word "substantial" its ordinary meaning, which is: "Of real worth and importance; of considerable value; valuable". The Court concluded that a little less than 20% was a substantial part. In Schainmars v Dean, 24 F2d 475, a case involving a transfer or a substantial part of the stock in trade, the court held that 16% to 20% was a substantial part. In Jubas v Sampsell, 185 F2d 333, 25% in quantity and 15% in value was considered a substantial part. In Employment Sec. Bd. v. Maryland Deliveries, 195 A2d 240, the court held the transfer of 77 employees and \$83,000 out of 28,000 employees and millions of dollars of assets to be a substantial portion of the business.

In the present case the assets transferred to A Co. were 16% of the California assets of X Co.; however, these assets were an entire division, the furnace division, of the business and therefore should be considered a substantial portion of business or property. Consequently, it must be concluded that the transfer qualified as a reorganization under Section 23251(a) of the Bank and Corporation Tax Law.