

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 274

November 2, 1964

### UNITARY INCOME: SALE OF STOCK – SALE OF CORPORATE ASSETS

#### Syllabus:

Taxpayer is incorporated in the State of Delaware and has its principal office in the State of New York. Taxpayer and a number of wholly-owned subsidiaries together are engaged in the manufacture and sale of merchandise through a chain of retail stores. Several retail stores are operated in California. The operations of the parent and the subsidiaries constitute a unitary business, and, moreover, the activities in California are part of the entire unitary business. Y was one of the taxpayer's wholly-owned subsidiaries, and its operations constituted a part of the unitary business. The legal and commercial domiciles of both parent and subsidiary were outside of California, and the subsidiary owned no property and engaged in no activities in this state.

In accordance with an agreement with Z, an unrelated company, the taxpayer affected a reorganization of Y in which some of the latter's assets were transferred to a newly-formed corporation, B. The parent company, X then sold the entire capital stock of the reorganized Y to Z.

Is any of the gain derived from the sale includible in unitary income subject to allocation in California?

The basic rule with respect to the treatment of gain on the sale of a unitary subsidiary's shares of stock is that the situs of the shares is determinative of the power to tax the income derived therefrom. Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48. With respect to the determination of situs, the opinion further states that "As to stock owned by foreign corporations doing business here, such stock or its income is taxable within this State only if it is in some way connected with the California franchise granted." *Ibid.*, 62.) The court held that since the commercial domicile of the parent corporation was in California and the securities from which the income was derived were related to the business of the parent, the entire income from the securities was subject to tax by California. Inasmuch as the law of this State ought to be applied so as to avoid double taxation of income with respect to another state whose law is similar, it must follow that this state should not attempt to tax income from securities having a tax situs in the other state.

Section 23040 provides that income derived from or attributable to sources in this state includes income from intangible property located or having a situs in this state. In the case of a multi-state, unitary business, the situs

of shares of the subsidiary held by the parent is not apportionable to all of the states in which the subsidiary or the parent does business. In Appeal of Dohrmann Commercial Company, decided by the Board of Equalization, February 29, 1956, the Board stated, in answer to the taxpayer's contention that the situs is spread among the various states, that "Since the percentage of the unitary income attributable to sources in each state is subject to fluctuation from year to year, the situs of the shares of stock would apparently shift from one state to another annually on the basis of income derived from each state, without regard to the legal or commercial domicile of either the owning or issuing corporation. This concept of situs is not supported by the authorities and is contrary to well settled principles of law." The Board distinguished the case of Holly Sugar Company v. Johnson, 18 Cal. 2d 218, which permitted allocation of a portion of the loss on the liquidation of a subsidiary to California, on the ground that the subsidiary had its legal and commercial domicile within this State and its activities were localized here.

However, granted that gain from the sale of shares of the subsidiary would generally not be unitary income subject to apportionment, the further question is raised as to whether the gain could be regarded as being derived from the sale of unitary assets, on the ground that the sale of the corporate shares was effected primarily for the purpose of disposing of assets used in the unitary business. In other words, if the facts indicate that in selling the subsidiary's shares the seller intended to dispose of specific assets used in the unitary business, can the gain be considered to be unitary income.

There appears to be no analogous situation where the sale of the entire stock of a corporation has been treated for tax purposes, with respect to the seller, as the sale of the corporate assets. In cases involving the buyer, where the stock of a corporation is purchased and the purchase is immediately followed by the liquidation of the corporation, it has been held that the transaction is in effect a purchase of corporate assets, for basis purposes. (Kimbell-Diamond Milling Company, 14 T. C. 74 aff'd. 187 Fed. 2d 718). The purchase of the stock and the immediate liquidation of the corporation in order to obtain its assets are deemed to be merely steps in a single transaction. The reasoning that the separate steps must be treated as a single transaction has no application, however, to the seller in the instant case since the sale of the Y shares is not in the nature of a step transaction, with respect to the seller. Y was not created as a step in the transaction by which Z acquired the assets. Therefore, there appears to be no basis for disregarding the separate corporate entity status of Y.

The question of whether there has been a sale of stock or a sale of the corporate assets has arisen under the Federal income tax law in situations where purchasers have attempted unsuccessfully to purchase the assets of a corporation, and, instead, have purchased the corporate stock from the shareholders. In a number of such cases, the Commissioner of Internal Revenue has contended that there was a sale of assets by the corporation, but the courts

have held that where there was no sale of assets negotiated by the corporation there was for tax purposes only a sale of stock by the shareholders and not a sale of assets by the corporation. Armored Tank Corp., 11 T. C. 644; Steubenville Bridge Co., 11 T. C. 789; Dallas Downtown Development Co., 12 T. C. 114; Robert Campbell, 15 T. C. 312. In the Armored Tank Co. case, the assets that were not to be transferred were spun off to a new corporation, must as in the instant situation. Furthermore, even though with respect to the seller it is held to be a sale of shares by the corporate shareholders rather than a sale of assets by the corporation, where the corporation is liquidated thereafter the transaction may be treated as a purchase of the corporate assets, for basis purposes. Dallas Downtown Development Co., supra, and Texas Bank & Trust Co., (1953) T. C. Memo., 12 T.C.M. 588.

It is concluded that the sale of shares of Y do not justify treating the transaction other than as a sale of stock. Therefore, under the principles established in the Southern Pacific Co. case and the Dohrmann Commercial Co. appeal, the gain derived from the sale is not subject to apportionment.