BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CONSOLIDATED VULTEE AIRCRAFT CORPORATION)
)
(Successor to Vultee Aircraft, Inc.))

Appearances:

For Appellant: W. M. Shanahan, its Treasurer

For Respondent: Burl D. Lack; Chief Counsel; Mark Scholtz, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 2'7 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) in denying the claim of Consolidated Vultee Aircraft Corporation (Successor to Vultee Aircraft, Inc.) for a refund of tax in the amount of $10,222.87 for the income year ended November 30, 1941.

The amount in controversy arises from a dispute as to the proper basis for the amortization of certain designs, drawings and engineering data. The determination of this question depends on whether, as Appellant claims, Appellant's predecessor, Vultee Aircraft, Inc., had previously acquired these items from Aviation Manufacturing Corporation in a taxable exchange, in which case their basis is their cost as of the time of such acquisition (Section 21(a), Bank and Corporation Franchise Tax Act), or whether, as maintained by the Commissioner, Vultee Aircraft, Inc. acquired the items in a transaction non-taxable under Section 20(b) of the Act, in which event their basis would be the same as it would be in the hands of Aviation Manufacturing Corporation (Section 21(a)(6)).

With the object in mind of securing additional capital for financing its operations., Aviation Manufacturing Corporation in 1939 formulated a plan which included the setting up of a new corporation to acquire all the property of its Vultee Aircraft Division. The plan consisted of several steps which were carried out in the following order: Vultee Aircraft, Inc., was incorporated on November 14, 1939, with an authorized capital stock of 1,000,000 shares. On November 15, 1939, it exchanged 450,000 shares of its stock for the assets of the Vultee Aircraft Division of Aviation Manufacturing Corporation. On November 30, 1939, Aviation Manufacturing Corporation sold 350,000 shares of this stock to its parent, Aviation Corporation, for $8.50 a share.

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On January 12, 1940, Vultee Aircraft, Inc., sold 300,000 additional. shares to underwriters at $8.50 a share, the intent being that the underwriters should resell the stock to the general public. On the same day Aviation Corporation issued Warrants to the underwriters calling for the sale of 100,000 shares of' Vultee Stock at $10.00 a share. Vultee Aircraft; Inc., also authorized the reservation and option for sale of 37,500 shares of its stock to its present and future officers, The total number of shares authorized as an original issue was, therefore, 787,500.

Prior to their consummation, all these steps had been decided on as part of a general plan and approved by Aviation Corporation. The steps and plan were set forth in a letter agreement from aviation Corporation to Aviation Manufacturing Corporation dated November 10, 1939. The letter was placed in the minutes of the meetings of the directors of both Corporations, and at the first meeting of the directors of Vultee Aircraft, Inc., held on November 15, 1939, the plan was discussed and the officers were authorized to negotiate with the underwriters in accordance with the plan.

It is asserted by Appellant, and not denied by the Commissioner, that the time that passed between the formation of the new company and the sale of its stock was barely long enough to enable the company to prepare and file a regiatration statement and the various other documents which had to be filed with the Securities and Exchange Commission and certain state regulatory commissions before the stock could be offered for sale to the public.

With regard to the same factual situation here involved, the United States Tax Court decided (Aviation Manufacturing Corporation, T.C. Memo. Op., Dkt. No. 754, March 22, 1944) that the plan resulted in a taxable transaction and did not fall within&Section 112(b)(4) of the Internal Revenue Code (similar to Section 20(b) (4) of the Bank and Corporation Franchise Tax Act), which provides for the non-recognition of gain or loss in a certain type of corporate reorganization.

The Commissioner maintains, however, thatthe acquisition by Vultee Aircraft, Inc., of the assets of the Vultee Aircraft Division of Aviation Manufacturing Corporation in exchange for its (Vultee's) stock was a tax-free exchange under Section 20(b)(5), which provides:

> "No gain or loss shall be recognized if property is transferred to a corporation by one or more taxpayers solely in exchange for stock or securities in such corporation, and immediately after the exchange such taxpayer or taxpayers are in control of the corporation ..."

Section 20(h) defines control as follows:

> "As used in this section the term 'control' means the ownership of stock possessing at least 80 per

"centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

The Tax Court decision was based on the ground that the transaction was not a reorganization, as defined by Section 112(g)(1)(C), inasmuch as Aviation Manufacturing Corporation and its sole shareholder, Aviation Corporation, were not in control of Vultee Aircraft, Inc., "immediately after the transfer," since they did not, as of the date of the completion of the plan on January 12, 1940, own 80% of the stock of Vultee Aircraft, Inc. The Court concluded, in this connection, that there was but one transaction consisting of several steps and that, therefore, the question of control "is to be determined by the situation existing at the time of the completion of the plan." Considering the evidence before us, we see no reason for differing with this conclusion.

It is to be observed that a transaction falls outside both Subdivisions (b) (4) and (b)(5) of Section 20 unless immediately after the transfer or exchange the transferor or transferors, in the case of (b)(5), or, by virtue of the definition of "reorganization" in Section 20(g), the transferor or its shareholders or both, in the case of (b)(4), are in control of the corporation to which the assets are transferred. Prior to the completion of the transaction under consideration and as a part of that transaction, however, aviation Manufacturing Corporation had sold to Aviation Corporation 350,000 of the 450,000 shares received by it from Vultee Aircraft, Inc. Quite irrespective of the status as transferors under Section 20(b)(5) of the holders of the 300,000 shares of Vultee Aircraft, Inc., sold to the underwriters, it follows that the transferors of property to Vultee Aircraft, Inc., were not in control of that corporation immediately after the transfer inasmuch d's they then held far less than 80% of its stock. Columbia Oil & Gas Co., 41 B.T.A. 38.

The transaction does not, accordingly, constitute a tax-free transfer under Section 20(b)(5) and the position of the Appellant as to the basis for amortization of certain assets acquired in that transaction must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 27 of the Bank and Corporation Brancnise Tax Act, that the action of Chas. J. McColgan, Franchisa Tax Commissioner (now succeeded by the Franchise Tax Board), in denying the claim of Consolidated Vultee Aircraft Corporation (Successor to Vultee Aircraft, Inc.,) for a refund of tax in the amount of $10,222.87

for the income year ended November 31, 1941, be and the same is hereby reversed.

Done at Los -Angeles, California, this 3rd day of October, 1950, by the State Board of Equalization.

Geo. R. Reilly, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST: F. S. Wahrhaftig, Acting Secretary