-BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
)
of)
)
ANDREWS MOTOR CAR COMPANY)

Appearances:

For Appellant: John J. Georgeson, Certified Public Accountant

For Respondent: Burl D. Lack, Chief Counsel; Hebard P. Smith, Associate Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code (formerly Section 25 of the Bank and Corporation Franchise Tax Act) from the action of the Franchise Tax Board on the protest of Andrews Motor Car Company to proposed assessments of additional tax in the amount of $317.32 for each of the taxable years ended June 30, 1948, and June 30, 1949, income year ended June 30, 1948.

Appellant was incorporated under the laws of California on April 14, 1947. On April 24, 1947, it acquired for cash from the stockholders of the Hollywood Lincoln-Mercury Company, a corporation engaged in the business of selling and servicing automobiles, all of the outstanding stock of that company. On May 1, 1947, all of the assets of Hollywood were transferred to Appellant and thereafter Appellant continued to operate the business previously conducted by that company. Hollywood was dissolved on May 12, 1947. The assets acquired by Appellant and their value on Hollywood's books were as follows:

Cash	$105,966.41
Bonds and securities	60,376.84
Accounts receivable less reserve	12,303.07
Inventories	58,322.66
Fixed assets less reserves	13,999.58
Deferred charges	2,479.05
Total	$253,447.61
Less liabilities and reserves	88,815.04
Net book value	$164,632.57

Appellant paid $263,982.57 for the total outstanding shares of Hollywood, or $99,350.00 in excess of the net book value.

Included in the above-listed assets were 100 shares of Boeing Aircraft Company, 100 shares of Canadian Pacific Railroad Company, and 200 shares of Pure Oil Company. These securities had a cost basis to Hollywood of $15,376.84, and a fair market value as of May 1, 1947, the date of acquisition by Appellant, of $7,862.50. Appellant sold these securities for $8,387.50 on February 15, 1948. Using a basis of $15,376.84, the basis to Hollywood, Appellant reported a loss after deducting the expense of sale of $7,102.28. The Franchise Tax Board, using a basis of $7,862.50, the fair market value on the date of acquisition by Appellant, determined a gain of $412.06, This adjustment; together with other adjustments not in issue in this appeal, resulted in a deficiency assessment of $317.32 for the taxable year ended June 30, 1948.

The Franchise Tax Board proposed a similar deficiency assessment for the taxable year ended June 30, 1949, on the ground that Appellant was subject to tax as a commencing corporation and under the provisions of Section 13(c) of the Bank and Corporation Franchise Tax Act Appellant's net income for the income year ended June 30, 1948, was the basis of its tax for that taxable year and also for the taxable year ended June 30, 1949. Appellant contends that it began to do business pursuant to a reorganization, and as provided in Section 13(g), is not to be -taxed as a commencing corporation.

The first issue for our decision concerns the proper basis to be used in determining the gain or loss on the sale of the securities. Appellant contends that the securities were acquired from Hollywood pursuant to a reorganization as defined in Section 20(g)(1), and that under the provisions of Section 21(a)(5)(B), they retained the same basis as in the hands of the transferor. Although not referred to by Appellant, we have also given consideration to Sections 20(b)(6) and 21(a)(12), which, in part, read as follows:

> Sec. 20(b) (6) No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation.
>
> Sec. 21.(a) The basis of property shall be the cost of such property; except that:
>
> (12) If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of Section 20(b)(6), then the basis shall be the same as it would be in the hands of the transferor.

The only theory upon which Appellant's position may be supported is that the acquisition of Hollywood's stock and the subsequent liquidation of that corporation constituted separate transactions. The facts show clearly, however, that the acquisition of the Hollywood stock and the liquidation of that corporation were but closely related steps of a single transaction. In such a situation we feel compelled to follow the United States courts which, in applying similar Federal statutes, have adopted the view that substance not form controls tax liability and have held that such a transaction is a purchase of property and not a reorganization. Commissioner v. Ashland Oil& Refining Co., 99 Fed. 2d 588; Prairie Oil and Gas Co. v. Motter, 66 Fed, 2d 309; Kimbell-Diamond Milling Co., 14 T.C. 74, affirmed 187 Fed. 2d 718, certiorari denied 342 U. S. 827. We conclude, accordingly, that the basis of the stocks for determining gain or loss is the cost to Appellant.

Appellant asserts that no part of a lump sum purchase price may be attributed to good will in the case of a franchised automobile agency; citing Floyd D. Akers, 6 T.C. 693. It contends, accordingly, that if the transaction in question did not constitute a reorganization the cost of the securities was book value increased by a proportionate share of the $99,350 excess paid by Appellant over book value of all the assets.

Appellant has not cited, and our own research has not disclosed, any authority to support the view that securities having an indisputable day to day market value are subject to apportionment of a lump sum purchase price paid for mixed assets of a business. To the contrary, assets having a readily realizable cash value are to be allocated a cost basis equal to that value, rather than a pro-rata portion of the lump sum purchase price. American Fork and Hoe Company, T.C.M. Dec., Docket 108334, entered September 22, 1943; L. M. Graves, T.C.M. Dec., Docket 28049, entered May 14, 1952; Grain King Manufacturing Co. v. Commissioner, 14 B.T.A. 793; Apex Brewing Co., Inc. v. Commissioner, 40 B.T.A. 1110.

The securities here in question were readily convertible to cash in an ascertainable amount and represented no more than an investment of surplus funds. To hold, under such circumstances, that any amount in excess of the market value of the securities should be allocated as their cost would be both unrealistic and contrary to the weight of authority. Accordingly, we conclude that the cost basis of the securities in the hands of Appellant was their market value at the date of acquisition.

The remaining question for determination in this appeal is whether Appellant is taxable under Section 13(c) as a commencing corporation, or under Sections 13(g) and 13(h) as a corporation beginning business pursuant to a reorganization.

Under the provisions of Section 13(c) a corporation commencing to do business in this State is required to pay a tax for the first year it commences to do business measured by the income of that year. It is also required to pay a tax for the second tax year based upon its income for the first year, if the first year is for a period of twelve months. Under Sections 13(g) and 13(h) a corporation which begins to do business in this State pursuant to a reorganization, as defined by Section 13(j), is not taxed as a commencing corporation.

As we have hereinbefore stated, we are of the opinion that the liquidation of Hollywood was but one step in a plan to purchase the assets of that corporation, and was not within the statutory definition of a reorganization. The case of San Joaquin Ginning Company v. McColgan, 20 Cal. 2d 254, cited by Appellant does not require a different conclusion than we have reached. In that decision the court adopted a liberal construction of the term "reorganization" to include any transaction which does not effect a substantial change in the continuity of interest. The transaction here in question, however, resulted in a complete transfer of ownership of the assets of Hollywood.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Andrews Motor Car Company to proposed assessments of additional franchise tax in the amount of $317.32 for each of the taxable years ended June 30, 1948, and June 30, 1949, be and the same is hereby affirmed.

Done at Sacramento, California, this 19th day of May, 1954, by the State Board of Equalization.

Geo. R. Reilly, Chairman

_____, Member

Paul R. Leake, Member

Wm. G. Bonelli, Member

Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary