

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal

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of

HEIL EQUIPMENT CO. OF NORTHERN CALIFORNIA

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Appearances:

For Appellant: **Alford R. Smith**, President

For Respondent: **Burl D. Lack**, Chief Counsel;  
**Cleo M. Gray**, Junior Counsel

O P I N I O N

This appeal is made pursuant to Section **25667** of the Revenue and Taxation Code from the action of the **Franchise Tax Board** on the protest of **Heil Equipment Co.**, of Northern California against proposed additional assessments in the amount of \$271.32 for the taxable year ended September 30, 1949, and the taxable year ended September 30, **1950**.

**Heil Equipment Co.** of Northern California, a corporation, commenced business October 1, **1948**. It succeeded to the business of **Alford R. Smith**, a sole proprietorship by the exchange of the assets of the **Alford R. Smith** proprietorship for stock of the new corporation. The stock had a par value of \$100 per share. Stock valued at \$90,000 was issued at the time of incorporation. **Alford R. Smith**, president of the corporation, received 750 shares in exchange for the assets of his business. Employees and others received 150 shares of stock of the par value of \$15,000 in exchange for cash and notes,

Among the assets transferred to Appellant was a part of inventory which had a basis of **\$17,414.56** in the hands of **Alford R. Smith**. The inventory was written up on the books of Appellant to **\$26,607.03**, the amount Appellant considered to be the market value of the inventory as of October 1, 1948.

The position of the Franchise Tax Board is that the transfer of the assets of the sole proprietorship by Mr. Smith to the Appellant constituted a tax free exchange within the terms of Section 20(b)(5), Bank and Corporation Franchise Tax Act (now Section 24521 of the Revenue and Taxation Code); that Appellant's basis for the assets acquired in the exchange was controlled by Section 21(a)(6)(A), Bank and Corporation Fran-

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chise Tax Act (now Section 24541 Revenue and Taxation Code) and that the basis of ~~ttne~~ pas inventory in the hands of the Appellant was \$17 414.56 the same basis it had in the hands of the transfer&. The Franchise Tax Board, accordingly, decreased Appellant's cost of goods sold in the amount of \$9,192.47 and increased its **taxable income** in a like amount.

Although Appellant urges the propriety of its **use of** market value as the basis of the inventory in question, it has not furnished us with any authorities in support of its **posi-**tion, ~~nor~~ has it suggested to us any reasons why provisions of the **Bank** and Corporation Franchise Tax Act relied upon by the Franchise Tax Board are inapplicable to the admitted facts.

Section 20(b)(5), **Bank** and Corporation Franchise Tax Act (now Section 24521, Revenue and Taxation Code) provided in part: "**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; but in the case of an exchange by two or more taxpayers this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to its interest **in** the property prior to the **exchange.**"

The definition of control as used in that section was set forth in Section 20(h) of the same Act and read 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."

There is no doubt of the control after the transfer of the property to Appellant. If the transfer of the assets of his business to the corporation by Smith is regarded as a separate transaction, it meets the **80%** test. Immediately after the exchange he was the owner of 750 of the 900 issued or subscribed shares.

Since it appears, however that the transfer by Smith was merely part of a **plan to** distribute the ownership of his business to include the employees and others who subscribed to shares for cash and notes, the entire proceeding must be treated as one transaction, (Nalliburton v. Commissioner, 78 Fed. 2d 265, Claude Neon Lights, Inc., 35 B.T.A. 424.). As held in those cases, for purposes of the **exchange money is property**, Immediately after the exchange the transferors collectively were the owners of all of the stock of the **corpo-**ration. So far as the facts show, the stook received by each

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transferor was in proportion to his interest in the property prior to the exchange,

The exchange of property by Mr. Smith and others for stock of Appellant was clearly a tax free exchange under Section 20(b)(5) supra, Sections 21(a)(6)(A) and (B) of the Bank and Corporation Franchise Tax Act (now Section 24541, Revenue and Taxation Code) provided in part: "If the property was acquired after December 31, 1920, by a corporation: (A) By the issuance of its stock or securities in connection with a transaction described in Section 20(b)(5) of this act ... (B) ... then the basis shall be same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made."

This section was substantially the same as Section 204(a)(8) of the Internal Revenue Code of 1924. The interpretation of that section as it applied to inventories received in a tax free exchange was determined in Grain King Manufacturing Co., 14 B.T.A. 793.

In that case assets, including merchandise inventory, were transferred to the corporation in exchange for stock. The transaction occurred in 1924. The question concerned the correct opening inventory of the corporation for the year 1924. After concluding that the transaction constituted a tax free exchange the court stated that "it is clear that the opening merchandise inventory to be used by petitioner in computing cost of goods sold during its first taxable year should be the cost to individuals who transferred the property to petitioner in exchange for stock..."

Section 13(c) of the Bank and Corporation Franchise Tax Act (now Section 23222 of the Revenue and Taxation Code) provided that where the first taxable year of a commencing corporation was a period of twelve months, the return for the first taxable year constituted the basis for the tax- for the second taxable year.

In view of the above considerations we conclude that the action of the Franchise Tax Board should be sustained for the two years in question,

ORDER

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

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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 Heil Equipment Co. of Northern California to proposed assessments of additional franchise tax in the amount of \$271.32 for the taxable years ended September 30, 1949, and 1950, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of August, 1956, by the State Board of Equalization.

Paul R. Leake, Chairman

Robert E. McDavid, Member

J. H. Quinn, Member

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Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary