BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HEATING EQUIPMENT MANUFACTURING COMPANY)

Appearances:

For Appellant: Julian Stern, Attorney at Law, and
Peter Helms, Certified Public Accountant

For Respondent: Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Heating Equipment Manufacturing Company for refund of franchise tax in the amount of $2,780.28 for the taxable year ended February 28, 1957.

Appellant, now dissolved, was a corporation in the business of manufacturing various types of furnaces. Frederick Anderson owned fifty percent of the outstanding stock of Appellant and John Baeza owned the remaining fifty percent.

On June 8, 1956, Anderson and Baeza entered into an Agreement and Plan of Reorganization with Pacific Industries, Inc., a California corporation. On October 8, 1956, pursuant to the plan, Anderson and Baeza exchanged all of the stock of Appellant for approximately one million shares of Pacific Industries, Inc. Anderson and Baeza divided the Pacific Industries stock equally between themselves. At the same time, and as a part of the same transaction, Anderson and Baeza exchanged all the stock which they owned in another corporation, San Carlos Manufacturing Company, for more stock in Pacific Industries. As a result of both of these transactions, Anderson and Baeza together ended up with a twenty-eight percent interest in Pacific Industries.

Ten days iater, Pacific's directors elected to dissolve Appellant and San Carlos and shortly thereafter the directors o f the latter companies voted to dissolve. On October 31, 1956, Appellant and San Carlos transferred all of their assets to Pacific Industries in complete liquidation. The stock of the two corporations was turned in and canceled. Certificates of winding up and dissolution were filed with the Secretary of State on December 11, 1956.

Thereafter, the businesses formerly operated by Appellant and San Carlos were operated as divisions of Pacific Industries. Anderson and Baeza became vice-presidents of Pacific Industries

and acted as general managers of the businesses which they had formerly operated under the ownership of the other corporations.

Appellant filed a claim for refund on January 16,1957, based on Section 23332 of the Revenue and Taxation Code which provides that if a taxpayer is dissolved during the taxable year it shall pay a tax only for the months of the taxable year which precede 'the effective date of such dissolution, Section 23332 provides further that the abatement shall not be allowed if the taxpayer is dissolved 'pursuant to a reorganization, consolidation, or merger. The question on this appeal is whether the transaction in this case was a reorganization under -Section 23251 which-. defines "reorganization" as the word is used in Section 23332.

Section 23251 during the period in question read as follows:

> "The term 'reorganization' as used in this chapter means (a) a transfer by a bank or corporation of all or a substantial portion of its business cr property to another bank or corporation if immediateiy after the transfer the transferor or its-stockholders cr both are in control of the bank or corporation to which the assets are transferred; or (b) a mere change in identity, form or place of organization however effected; or (c) a merger or consolidation; or (d) a distribution in liquidation by a bank or corporation of all or a substantial portion of its business or property to a bank or corporation stockholder, and the bank or corporation stockholder continues all or a substantial portion of the business of the liquidated bank or corporation. As used in this section the term 'control' means the ownership of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of the bank or corporation."

Respondent contends that this case falls within the meaning of "reorganization" as defined in either (c) or (d).

In San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254, the California Supreme Court held that a broad interpretation should be given to the word "merger" as used in the predecessor of the above-quoted section. At that time, the statute had no provision equivalent to subdivision (d) of the section here involved. The court concluded that a merger occurred when, under a plan of liquidation, a wholly-owned subsidiary transferred its assets to its parent corporation and dissolved. As authority for its conclusion, the Court relied upon Federal decisions. construing a similar statute. (Section 112 of the Revenue Act of 1928. Predecessor and successor sections ware the same prior to Revenue Act of 1934.)

It has been stated by the Federal courts that "a merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist, and the merging corporation alone survives." (Cortland Specialty Co. v. Commissioner, 60 Fed. 2d 937, cert. den., 288 U. S. 599; Fisher v. Commissioner, 108 Fed. 2d 707, cert. den., 310 U. S. 627.) It is apparent that this definition applies literally to the situation before us.

The courts have treated as mergers a variety of procedures by which one corporation acquires all or substantially all of the assets of another, including situations outside of the strict wording of the above definition, that is, situations where the transferee acquires no stock in the transferor. The primary requisite established by the Federal cases is that in order to constitute a--merger, the former owners must retain a proprietory interest in the transferee, representing a substantial part of the value of the thing transferred. The continuing interest need not constitute or even closely approach a majority or controlling interest in the transferee. (See Nelson C. v. Helvering, 296 U. S. 374; Helvering v. Minnesota Tea Co., 296 U. S. 378; Miller v. Commissioner, 84 Fed.2d 415; Putnam v. U. S., 149 Fed. 2d 721; John S. Woodard, 30 B.T.A. 1216; 173 A.L.R. 912. Cf. Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462; LeTulle v. Scofield, 308 U. S. 415.)

Appellant has argued that the intermediate step by which Pacific acquired the stock from Anderson and Baeza should be ignored and that the entire transaction should be regarded as a purchase of assets by Pacific, citing Kimbell-Diamond Milling Co. v. Commissioner, 187 Fed. 2d 718. But even if this argument has merit, the transaction would constitute the acquisition of assets for stock, thus preserving a continued interest on the part of the sellers, and not, as in Kimbell-Diamond, a purchase of assets for cash. As may be seen from an examination of the Federal cases previously cited, this would not destroy the character of the transaction as a merger.

It does, indeed, appear that Pacific's ultimate purpose was to acquire assets in exchange for stock. The purpose of Anderson and Baeza was quite apparently to combine their businesses with Pacific and to exchange their interests in their businesses for smaller interests, proportionate to the value of the transferred assets, in a larger business. This would seem to constitute a reorganization both in purpose and in effect.

Appellant has cited Andersen-Carlson Manufacturing Co. v. Franchise Tax Board, 132 Cal. App. 2d 825. There the taxpayer corporation was indebted to another company, Rome cable corporation. The taxpayer entered into a contract with Rome whereby Rome loaned the taxpayer a substantial additional amount and Rome

was granted an option to purchase all the assets of the taxpayer in exchange for the issuance of a certain number of shares of Rome stock and the assumption of. all of the taxpayer's liabilities One year and three months later, Rome gave notice that it elected to exercise its option to purchase. Three months thereafter the actual transfer of title and issuance of stock took place. The taxpayer was immediately dissolved and its assets (the Rome stock) were distributed to its shareholders. These shareholders as a group thereupon owned about seven percent of all the shares of Rome stock outstand-ing. The District Court of Appeal concluded that this transaction did not constitute a reorganization, consolidation or merger, but a bona fide sale of assets.

It was stated in Banner Machine Co. v. Routzahn, 107 Fed. 2d 147, cert. den. 309 U.S. 676, with respect to the Federal provisions, -that "as interpreted in the Minnesota Tea Company and the Pinellas Ice & Cold Storage Company cases, supra, the statute embraces circumstances 'difficult to delimit.' It follows that cases arising under this statute will necessarily be decided upon their peculiar facts." The differences between the Andersen-Carlson case and that-before us in respect to the relationship of the parties, the purposes involved and the steps leading to the transfer of assets a-re readily apparent.

In accordance with the views of the California Supreme Court in San Joaquin Ginning Co. v. McColgan, supra, that the word "merger" is to be given a broad interpretation to effect its purposes and that Federal decisions under a similar statute are proper guides, we conclude that the transaction here involved constituted a "merger" within the meaning of subdivision (c) of Section 23251. It is thus unnecessary to determine whether the transaction is embraced by subdivision (d) of that section.

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 26077 of the Revenue and Taxation Code, that the action

of the Franchise Tax Board in denying the claim for Heating Equipment Manufacturing Company for refund of franchise tax in the amount of $2,780.28 for the taxable year ended February 28, 1957, be and the same is hereby sustained.

Done at Sacramento, California, this 14th day of November, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary