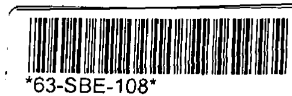

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MEYENBERG-OLD FASHION PRODUCTS COMPANY)

Appearances:

For Appellant: Gordon T. Stine, Manager, Tax Department, Ernst & Ernst

For Respondent: Israel Rogers, Assistant 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 Meyenberg-Old Fashion Products Company against proposed assessments of additional franchise tax in the amounts of $9,603.90 and $470.42 for the income year 1957 and $19,122.81 and $119.67 for the income year 1958.

In 1948 the Meyenberg Milk Products Company (hereafter "Meyenberg"), a corporation engaged in the milk processing business, acquired all of the stock of Old Fashion Products, Inc. (hereafter "Old Fashion"), a corporation engaged in the ice cream business. Early in 1957 the Starrett Corporation (hereafter "Starrett"), an unrelated firm, entered into negotiations with Meyenberg for the purpose of acquiring the latter's operating business.

Pursuant to an agreed plan, Appellant was incorporated on April 8, 1957, and all of the assets of Old Fashion were transferred to Meyenberg in complete liquidation on April 30. Immediately thereafter, Meyenberg transferred all of its operating assets except land, buildings, equipment and some miscellaneous assets not related to the milk processing or ice cream business, to Appellant in exchange for all of its stock. The plant and land were leased to Appellant for a term of seventeen years with an option to buy. The plan was consummated on May 17 when Meyenberg transferred all of its stock in Appellant to Starrett in exchange for 49.9 percent of Starrett's common stock.

Two years later, on April 27, 1959, Starrett acquired all of the stock of Meyenberg in exchange for additional shares of Starrett. This last transaction was not a part of the original plan.

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Appellant protests those portions of the Franchise Tax Board's proposed assessments which arise from the application of Section 23222 of the Revenue and Taxation Code to Appellant's franchise tax liability. Section 23222 provides for the computation of tax on a commencing corporation but, pursuant to Section 23252, is inapplicable when a corporation commences to do business pursuant to a "reorganization," as defined in Section 23251.

Pertinent portions of Section 23251 provide:

> The Term "reorganization" as used in this chapter means (a) a transfer by a ... corporation of all or a substantial portion of its business or property to another . . . corporation if immediately after the transfer the transferor or its stockholders or both are in control of the ... corporation to which the assets are transferred; or ...(c) a merger or consolidation; . . . 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 ... corporation,

The sole question presented for decision is whether Appellant commenced to do business pursuant to a transaction that qualifies as a reorganization under either parts (a) or (c) of Section 23251. Assuming that, immediately following the transfer of the milk and ice cream business to Appellant in exchange for all of its stock, the requirements of part (a) had been met, the Franchise Tax Board argues that this was but an intermediate step in a single transaction in which Meyenberg divested itself of the required 80 percent control and, therefore, it cannot qualify under that provision. We agree.

The component steps of a single transaction may not be treated separately for income tax purposes, (Prairie Oil & Gas Co. v. Motter, 66 F. 2d 309; Hazeltine Corp. v. Commissioner, 89 F. 2d 513; Helvering v. Bashford, 302 U. S. 454 [82 L. Ed. 367].) The ownership of Appellant's stock by Meyenberg was transitory and incident to a plan which required its immediate transfer. That transfer was not an independent transaction but an essential part of the plan. Control is determined as of the completion of the integral plan. Viewing the transaction as a whole, Meyenberg did not have control of Appellant when the interdependent transfers were completed. (United Light & Power Co., 38 B.T.A. 477, 485, affirmed 105 F. 2d 866 cert. denied 308 U. S. 574 [84 L. Ed. 481].) It follows that part (a) of Section 23251 is inapplicable,

Appellant urges that if we apply the single transaction theory to this case, we must include as a final step the 1959 exchange of Meyenberg stock for Starrett shares. At the outset

tie note that this argument must fail because nothing in the record indicates that this last act accomplished the 80 percent control required by part '(a).

Our decision does not rest on that ground alone, however, for Appellant's argument is subject to a more fundamental weakness in that there is no basis on which to include the final transfer in the original transaction. Appellant concedes that this was never part of the original plan. There is no reason to believe that the last step, taken some two years later, was in any way interdependent upon or related to the earlier steps. Thus, it must be considered a separate transaction. The courts have stated that the test of a single transaction is whether the steps taken were so interdependent that the legal relations created by one step would have been fruitless without completion of the whole series of steps. (Manhattan Building Co., 27 T. C. 1032, 1042; American Bantam Car Co., 11 T. C. 397, affirmed 177 F. 2d 513, cert. denied 339 U. S. 920 [94 L. Ed. 13441.) We conclude that Appellant's contention fails this test,

Appellant argues in the alternative that the transfer of assets from Old Fashion to Appellant through Meyenberg resulted in a "de facto" merger which falls within the meaning of the term "merger" as used in part (c) of Section 23251. The California Supreme Court in San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254 (125 P. 2d 36], held that in construing the term "merger," as used in the predecessor of Section 23251, the Federal decisions interpreting a similar Federal statute are proper guides. After reviewing the pertinent Federal authorities, we conclude that Appellant's alternative argument is also incorrect.

In order to establish that a merger occurred within the meaning which concerns us here it must be shown that Meyenberg, the former owner of a portion of the assets and the former stockholder of Old Fashion which owned the balance of the assets, retained a definite and material continuing interest in the transferred assets. (Helvering v. Minn. Tea Co., 296 U. S. 378 [80 L. Ed. 284]; Cortland Specialty Co. v. Commissioner, 60 F. 2d 937.) The indirect interest retained by Meyenberg, as the owner of part of the stock of Starrett, which-in turn owned the stock of Appellant, the ultimate owner of the assets, does not qualify (Groman v. Commissioner, 302 U.S. 82 [82 L. Ed. 63]; Bashford v. Commissioner, 302 U. S. 454 [82 L. Ed. 367]; United Light & Power Co. v. Commissioner, 105 F. 2d 866, cert. denied 308 U. S. 574 [84 L. Ed. 481J; Commissioner v. First National Bank of Altoona, 104 F. 2d 865, cert. dismissed 309 U. S. 691 [84 L. Ed. 10335.)

Finally, Appellant states that Meyenberg's exchange of Appellant's stock for Starrett shares was reported as a tax-free exchange and that this treatment was not challenged by the Franchise Tax Board. Appellant reasons from this that the transaction must have qualified under the tax-free exchange provisions

of the code and therefore it must also qualify as a reorganization under Section 23251.

The definition of a reorganization for the purpose of determining whether an exchange is tax-free differs in material respects from the definition that is controlling here. (See Rev. & Tax. Code, §24562.) One significant difference is that Section 24562, Subdivision (b)(3), unlike section 23251, expressly provides that a transaction "shall not be disqualified by reason of the fact that part or all of the assets which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets." Since the question is not before us, however, we do not purport to decide whether there was a reorganization within the meaning of Section 24562. For present purposes, it is sufficient that in our judgment the issue presented by the instant appeal has been properly decided based on the controlling authorities.

O R D E R

Pursuant to the views expressed in the opinion of the Board **on file in this proceedings, 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 Meyenberg-Old Fashion Products Company against proposed assessments of additional franchise tax in the amounts of $9,603.90 and $470.42 for the income year 1957 and $19,122.81 and $119.67 for the income year 1958, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

________________, Member

ATTEST: H. F. Freeman, Executive Secretary