

BEFORE THE 'STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
S & K SALES CO,)

For Appellant: Alvin T. Levitt
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

Gary Paul Kane
Counsel

OP I N I ON

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 S & K Sales Co. against a proposed assessment of additional franchise tax in the amount of \$3,424.61 for the income year ended March 31, 1963.

Appellant S & K Sales Co, and S & K Sales Corporation, Specialty Division, hereafter referred to as "Specialty Division," were California corporations owned by the same shareholders in the following percentages:

<u>Shareholder</u>	<u>Appellant</u>	<u>Specialty Division</u>
Joseph Selby	45.05%	45%
Marion P. Hilpisch	36.3%	10%
Joseph Friend	18.2%	45%

The main business of Specialty Division consisted of selling on a commission basis a type of merchandise owned by appellant. These sales were made by employees of appellant acting as agents for Specialty Division.

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At the end of 1962, Specialty Division terminated its business and started liquidation of assets which consisted of office equipment (adjusted basis of \$472.30), cash, and government bonds. By March 7, 1963, all these assets were liquidated and the proceeds distributed to the shareholders. None of these assets were transferred to appellant. On March 25, 1963, the corporation filed a Certificate of Winding Up and Dissolution with the Secretary of State. Appellant resumed direct control over its employees who had been acting as agents for specialty Division and assumed and continued to service the sales accounts of the terminated corporation.

Respondent determined that the above facts constituted a reorganization under either subdivision (a) or subdivision (c) of section 23251 of the Revenue and Taxation Code and, consequently, that appellant should be taxed upon the income earned by specialty Division during the period April 1, 1962 through March 31, 1963. Whether this determination is correct is the sole issue of this appeal.

Section 23251 defines "reorganization." The relevant portions of this section state:

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 or property to another bank or corporation if immediately after the transfer the transferor or its shareholders or both are in control of the bank or 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 bank or corporation.

Prior to the enactment of the reorganization sections a mere change in the corporate structure of a business produced an abatement or refund of franchise tax and allowed the net income of the transferee's last taxable year to escape taxation entirely. Sections 23251 through 23254 of the Revenue and Taxation Code were added to remedy these inequities. (See Traynor and Keesling, Recent Changes in the Bank and Corporation Franchise Tax Act (1934) 23 Cal. L. Rev. 51, 62.) With this in mind the court in San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254 [125 P.2d 36], stated that the terms

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reorganization, merger and consolidation should be liberally construed, and the term merger is not limited to a statutory merger but also includes a de facto merger.

We think that in the instant situation a merger occurred under subdivision (c) of section 23251. 'Specialty Division was a service organization engaged in selling products owned by appellant. When Specialty Division dissolved, appellant assumed the sales accounts, experienced employees and reputation of the terminated corporation. In a service business these items may well be the most valuable assets of the corporation. (Moffatt v. Commissioner, 363 F.2d 262.) We think they were in the present case. The fact that a minor amount of office equipment and some liquid assets, unnecessary to the operation of the service business, were not transferred to appellant does not change this conclusion. Specialty Division's business was "absorbed" by appellant, which continued the combined business without interruption. (Appeal of Hall-Roepke-Petersmeyer Co., Cal. St. Bd. of Equal., Nov. 6, 1967; Heating Equipment Mfg. Co. v. Franchise Tax Board, 228 Cal. App. 2d 290 [39 Cal. Rptr. 453].)

The primary requisite of a merger is that the former owners of the merged corporation must have retained a continuing proprietary interest in the transferee corporation which was definite and substantial and represented a material part of the value of the thing transferred. (Heating Equipment Mfg. Co. v. Franchise Tax Board, supra.) In the instant situation the same three shareholders owned all the stock in both Specialty Division and appellant. This ownership was a sufficient continuing interest, even though there was some variation in the percentage of stock ownership between the shareholders, (Appeal of Hall-Roepke-Petersmeyer Co., supra; Miller v. Commissioner, 84 F.2d 415; Rev. Rul. 66-224, 1966-2 Cum. Bull. 114.)

We conclude that the instant situation was a reorganization under subdivision (c) of section 23251, and therefore appellant's franchise tax should be computed accordingly. In view of this conclusion it is unnecessary to consider respondent's alternative contention that a reorganization occurred under subdivision (a) of section 23251.

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,

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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 S & K Sales Co. against a proposed assessment of additional franchise tax in the amount of \$3,424.61 for the income year ended March 31, 1963, be and the same is hereby sustained.

Done at Sacramento , California, this 7th day of May , 1968, by the State Board of Equalization.

Paul O'Neil, Chairman
John W. Lynch, Member
Geo. K. Pease, Member
_____, Member
_____, Member

ATTEST : *[Signature]*, Secretary