BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
COLOR SERVICE, INC., -TAXPAYER,)
LENARD E. NOLAND AND LLOYD T.)
CRELIA, TRANSFEREES)

Appearances:

For Appellants: Orville L. Marlett
Attorney at Law

For Respondent: John D. Schell
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 'Co-lor Service, Inc., taxpayer, Lenard E. Noland and Lloyd T. Crelia, transferees'; for refund of franchise tax in the amount of $5,322.96 for the income year 1967.

Color Service, Inc., was a California corporation which was formed in 1959 to engage in the business of photoengraving. The company's stock was held in equal portions by Lenard E. Noland and Lloyd T. Crelia (hereafter referred to as appellants). On January 26, 1968, Color Service, Inc., entered into a "Plan of Aeorganization and Agreement" with Udico Corporation. Pursuant to this agreement, on March 20, 1968, Color Service transferred all of its "assets, business and goodwill" to Udico, and that corporation assumed certainof the transferor's liabilities. In exchange, Color Service received 47,000 shares of Udico stock, which equalled 8.8 percent of the total shares of that corporation. The exchanged Udico stock was distributed to Messrs. Noland and Crelia, and on June 7, 1968, Color Service filed a certificate of

winding up and dissolution in the office of the Secretary of State.

The agreement stated that the above transaction "is the type defined by section 368(a)(1)(C) of the Internal Revenue Code," and also provided for the payment of certain additional shares of Udico stock, contingent upon the earnings of the division of Udico which had been created to operate the transferred assets. This new division employed most of the former personnel of Color Service.

The present appeal is concerned with appellants' claim that there should be a partial refund of the prepaid franchise tax of Color Service, Inc., for the taxable year 1968, since the corporation was only in existence for a portion of that year. The Franchise Tax Board determined that the transaction in question was a reorganization, in the form of a merger, and therefore denied the claim. Whether this determination was correct is the sole issue of the instant case.

Section 23332 of the Revenue and Taxation Code provide's in part:

> ... any taxpayer which is dissolved or withdraws from the state during any taxable year shall pay a tax only for the months of the taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by (a) the net income of the preceding income year or (b) a percentage of net income determined by ascertaining the ratio. which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of the income year, whichever is the lesser amount .... The taxes levied under this chapter, shall not be subject to abatement or refund., because of the cessation of business or corporate existence of any taxpayer pursuant to a reorganization, consolidation, or merger (as defined by Section 23251)....

Section 23251 of the same code provides:

> 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 stockholders or 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 (other than a distribution to which Section 24504(b)(2) applies) 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.

A merger can be generally described as "the -absorption of one corporation by another which survives, retains its name and corporate identity together with the added capital-, franchises and powers of the merged corporation and continues the combined business." (Heating Equipment Mfg. Co. v. Franchise Tax Board, 228 Cal. App. 2d 290, 302 [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 present appeal, such an interest was retained by the appellants, the former shareholders of Color Service., Inc., through their ownership of 8.8 percent of Udico's stock. (Appeals of Duro Fittings Co. and Duro Sales Co., Cal. St. Bd. of Equal., Feb. 5, 1963.) In the above. cited case and in the Appeals of Diamond Gardner Corp., etc., Cal. St. Bd. of Equal., decided February 5, 1963, we held that mergers occurred in situations which were substantially identical to the instant transaction.

Appellants contend that Andersen-Carlson Mfg. Company v. Franchise Tax Board, 132 Cal. App. 2d 825

[283 P.2d 278], controls the present appeal. In that case a debtor corporation, in return for a large loan, gave the creditor company an option to acquire all the assets of the debtor in exchange for a certain amount of the creditor's stock. The court held that a reorganization did not occur when the option was exercised approximately 15 months after it was given. In reference to the Andersen case, supra, the court in Heat-inn Equipment Mfg. Company v. Franchise Tax Board, supra, 228 Cal. App. 2d 290, 302 [39 Cal.Rptr. 453], stated at pages 307 and 308:

> ... We find a significant distinction between Andersen and the instant case in the debtor-creditor relationship between the parties and we feel that the court there could have very well concluded that the ultimate transaction was merely incidental to such relationship and did not derogate from the good faith of the arrangement thus availed of by the creditor.. ..

We think that the holding in the Andersen case, supra, should be limited to the unique circumstances, involved there. (Appeals of Diamond Gardner Corp., etc., supra.) Appellants' other contention, that the amount of Udico stock which they were given was insufficient to classify the transaction under subdivision (a) of section 23251, is irrelevant to a determination of whether subdivision (c) of that section applies.

We conclude that the instant transaction was a reorganization, in the form of a merger, and therefore appellants are not entitled to a partial refund of the prepaid franchise tax in question.

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,

Appeal of Color Service, Inc., Taxpayer, et al.

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 of Color Service, Inc., taxpayer, Lenard E. Noland and Lloyd T. Crelia, transferees, for refund of franchise tax in the amount of $5,322.96 for the income year 1967 be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of August, 1970, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary