BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WOODBINE CORPORATION, SUCCESSOR IN)
INTEREST TO SALAROSE CORPORATION)

For Appellant: Fred Richard Shapiro
Certified Public Accountant

David R. Chan
Certified Public Accountant

For Respondent: Bruce W. Walker
Chief Counsel

Brian W. Toman
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 Woodbine Corporation, successor in interest to Salarose Corporation, against a proposed assessment of additional franchise tax in the amount of $69,748.70 for the income year ended September 30, 1970.

The issue presented is whether, pursuant to section 23253 of the Revenue and Taxation Code; Woodbine Corporation (hereinafter appellant) must include in the measure of franchise tax for its income year ended September 30, 1970 the net gain earned during that year by Salarose Corporation (hereinafter Salarose). 'The applicability of section 23253 to the facts presented herein depends on whether a transfer of assets to appellant in liquidation of Salarose constituted a reorganization within the meaning of section 23251 of the Revenue and Taxation Code. 1/

Nathan Shapell, David Shapell, and Max Webb (hereinafter the individuals) have engaged in the development of residential housing projects since 1953. The individuals have conducted business through a group of controlled corporations which, since 1969, has included Shapell Industries, Inc. (hereinafter Shapell), appellant, Salarose, and several other affiliated corporations.

Shapell was incorporated under the laws of Delaware in 1969 and qualified to do business in California in that year. The individuals own seventy percent of Shapell's stock and serve as directors and major officers of the corporation. Positioned at the top of the structure of affiliated corporations controlled by the individuals, Shapell was formed for the general purpose of developing major housing projects in southern California. As will be explained in greater detail below, Shapell conducted its business through various first and second-tier wholly owned subsidiaries.

Appellant, a California corporation, has been a wholly owned subsidiary of Shapell since 1969. Its major function as a component member of the controlled group was to locate and acquire for residential development large parcels of unimproved property. After acquiring a parcel, appellant would subdivide the property into separate tracts and convey each tract to a "land-owning" subsidiary of itself or Shapell. Each "land-owning" subsidiary would direct the construction and sale of single family homes within its particular tract.

1/ Unless otherwise indicated, all code references hereinafter are to the Revenue and Taxation Code.

Salarose was incorporated in California on August 16, 1968 as a wholly owned subsidiary of appellant. Like its parent, Salarose kept its books and filed its returns on the basis of an income year ended September 30. The primary function of Salarose as a member of the controlled group was to operate as a "land-owning" subsidiary of appellant.

During 1968, appellant acquired for residential development a 140-acre parcel of unimproved property located in Seal Beach, California. Appellant subdivided the property into a number of separate tracts and conveyed most of the tracts to the "land-owning" subsidiaries. Apparently, with respect to development of the tracts which it retained, appellant also operated as a "land-owning" subsidiary.

Upon acquiring its respective tract, each "land-owning" subsidiary hired the S & S Construction Company, a wholly owned subsidiary of Shapell, as general contractor in cha-ge of subdividing the tract into lots and constructing single family homes on the lots. During the period of construction, some of the subsidiaries advanced funds to the general contractor to finance construction. While the record on appeal does not identify the ultimate source of such funds, it appears that they constituted operating capital provided to the subsidiaries by appellant and Shapell. Each of the "land-owning" subsidiaries also hired the Shapell Land Company, another wholly owned subsidiary of Shapell, to handle the advertising and sale of the homes.

Shortly after its incorporation, Salarose received from appellant a tract within the Seal Beach housing project. Salarose employed the S & S Construction Company to build 130 homes within the tract and the Shapell Land Company to advertise and sell the homes. Although Salarose did not advance funds to the construction company in connection with its own tract, it did advance funds to finance the construction on other tracts. Construction of homes on the Salarose tract was completed late in 1969 and, by August 13, 1970, all but seven of the homes had been sold to the public. In connection with the financing of these sales, Salarose acquired twenty-two second trust deeds. Thereafter, Salarose transferred the remaining seven homes and the twenty-two second trust deeds to Shapell for cash.

On September 22, 1970, in exchange for the return of all of its stock, Salarose transferred to

appellant cash in the amount of $1,048,347. On September 28, 1970, just two days prior to the close of its income year, Salarose was dissolved. During the corporate life of Salarose, the individuals served as the major officers of both appellant and Salarose. Following the dissolution of Salarose, development of the Seal Beach housing project was continued through Shapell; appellant, and other members of the controlled group.

The $1,048,347 transferred from Salarose to appellant apparently represents the net income earned by Salarose during its final income year from its real estate development activities. Under the law in effect at the time of the dissolution of Salarose, a dissolving corporation was not required to pay franchise tax based on the income earned during its final year of operation. (Rev. & Tax. Code, § 23332.) Thus, since Salarose dissolved at the close of its income year ended September 30, 1970, it was not required to pay franchise tax based on the income earned during that year.

Section 23253 provides, in pertinent part:

> Where, pursuant to a reorganization, all or a substantial portion of the business or property of a taxpayer, a party to the reorganization, is transferred to another taxpayer, a party to the reorganization:
>
> (a) The net gain of the transferor from the business or property so transferred to any taxpayer for the taxable year in which the transfer occurs, shall be included in the measure of the tax on the transferee for the taxable year succeeding the taxable year in which the transfer occurs ....

The term "reorganization" as used in section 23253 is defined in section 23251 as:

> (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 stock holders 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 ... 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. ...

The proposed assessment which gave rise to this appeal was issued by respondent on the ground that the distribution of cash and other property from **Salarose** to appellant and Shape11 constituted a reorganization under subdivision (a), (b), or (d) of section 23251. Accordingly, it is respondent's position that the measure of appellant's franchise tax obligation for the income year ended September 30, 1970 should have included, pursuant to section 23253, the net income earned by **Salarose** during that year. For the reasons stated below, it is our opinion that the transfer of cash and other property from **Salarose** to appellant and Shape11 in anticipation of the dissolution of **Salarose** constituted a reorganization within the literal and contemplated meaning of subdivision (d) of section 23251 and, therefore, that respondent's action in this matter must be sustained.

Sections 23251 and 23253 are based on former sections 13(j) and 13(h), respectively, of the Bank and Corporation Franchise Tax Act. In recommending the enactment of the former **provisions**, the California Tax Research Bureau made the following comment:

> The present provisions of **section 13** relating to the computation of the taxes on banks and corporations which dissolve or withdraw from the State ... make no exception in the case of corporation reorganizations, consolidations or mergers. Hence, simply because of a change in the corporate structure by which **a** business is operated, the amount of taxes due the State for the privilege of operating that business in a corporate form will vary from what it would have been otherwise. Provision should be made for measuring the tax by the same income and allowing the same offsets had a reorganization, consolidation or merger not occurred. (Appendix, Legislative Journal, 1933.)

Thus, a primary purpose for the enactment of sections 23251 and 23253 was to prevent the dissolution of a corporation from resulting in avoidance of franchise tax in

situations where the ultimate ownership, control, and operation of the dissolving corporation's business does not substantially change as a result of the dissolution. (See San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254, 259 [125 P.2d 36] (1942); Heating Equipment Mfg. Co. v. Franchise Tax Board, 228 Cal. App. 2d 290, 301 [39 Cal. Rptr. 453] (1964); Bethlehem Pacific Coast Steel Corp. v. Franchise Tax Board, 203 Cal. App. 2d 458, 463 [21 Cal. Rptr. 707] (1962).)

As indicated above, the essential elements of a subdivision (d) reorganization are (1) "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 (2) continuation by the bank or corporation stockholder of "all or a substantial portion of the business of the liquidated bank or corporation." In ascertaining whether these elements are present in the instant appeal, we are mindful that the rule to be applied in interpreting the provisions of section 23251 is the rule of liberal construction. (San Joaquin Ginning Co. v. McColgan, supra.)

The record on appeal indicates that Salarose, a wholly owned subsidiary of appellant and a sub-subsidiary of Shapell, transferred all of its assets, consisting primarily of approximately one million dollars in cash, seven homes, twenty-two second trust deeds, and minor accounts receivable, to appellant and Shapell between August 13, 1970 and September 28, 1970. In our view, these distributions were part of a single integrated transaction made in contemplation of the liquidation of Salarose. Accordingly, we conclude that Salarose made a distribution in liquidation of all of its property to a corporation stockholder and, therefore, that the first element of a subdivision (d) reorganization is satisfied. 2/

Appellant contends that "there was not a transfer of all or a substantial portion of Salarose Corporation's business or property, because at the time of the

2/ The fact that some of the assets of Salarose were transferred to Shapell rather than directly to appellant is of little significance with respect to the ultimate question whether the transfer effected a substantial change in the ownership or control of those assets. (See Bethlehem Pacific Coast Steel Corp. v. Franchise Tax Board, 203 Cal. App. 2d 458 [21 Cal. Rptr. 707] (1962).)

liquidation of Salarose Corporation its business affairs had been essentially completed and its assets had essentially been disposed of so that there was no substantial portion of its business or property remaining which could be transferred." Implicit in appellant's argument is the assumption that the cash transferred pursuant to the liquidation of Salarose does not constitute "property" as the term is used in subdivision (d). However, appellant has offered no authority in support of its restrictive interpretation of subdivision (d). Moreover, if accepted by this board, appellant's construction of the term "property" could lead to complete frustration of the intended purpose behind section 23253. The consequences of that section could be circumvented, for example, merely by having the liquidating corporation convert its non-cash assets to cash prior to any distribution of "property" to the corporation stockholder. In the absence of any evidence to the contrary, we must conclude that the Legislature did not intend to exclude cash distributions from the operation of section 23253.

Turning to the second element of a subdivision (d) reorganization, we find the question whether appellant continued "all or a substantial portion of the business" of Salarose complicated by the lack of a clear distinction between the "business" of Salarose and that of appellant. It is this absence of a distinct economic endeavor on the part of Salarose, however, which leads us to conclude that the continuity of business requirement of subdivision (d) is satisfied by the facts of this appeal.

As we have indicated, sections 23251 and 23253 were enacted to prevent the avoidance of franchise tax in situations where the dissolution of a corporation effects a mere change in the corporate structure through which a business is operated. During its brief corporate existence, Salarose operated as a member of a group of functionally related corporations which, comprised integral parts of a unified and centrally managed and controlled general business enterprise. Thus, the "business" of Salarose was also the "business" of appellant, Shapell, and the other affiliated corporations, and the liquidation and dissolution of Salarose caused no interruption in the operation of the common business enterprise. To the contrary, the transfer of cash and other property to appellant and Shapell pursuant to the liquidation of Salarose represented an insignificant change in the corporate structure through which the "business" was conducted.

Appellant contends that Salarose was formed solely for the purpose of directing the development of a particular tract within the Seal Beach housing project. Accordingly, since Salarose had essentially completed development of the tract prior to its liquidation, it is appellant's position that Salarose had no "business" which could have been continued by appellant following the liquidation. In. support of its position, appellant cites the decision of this board in the Appeal of Sunny Homes, Inc., et al.', decided August 1, 1966. In Sunny Homes we held that under the circumstances presented the liquidations of wholly owned subsidiaries whose primary business was residential real estate development did not constitute subdivision (d) reorganizations.

Initially, it should be noted that appellant has offered no concrete evidence, such as the Articles of Incorporation of Salarose or the minutes of its initial board meetings, in support of the assertion that Salarose was created solely to develop a single tract within the Seal Beach project. The record indicates only that Salarose was formed to operate as a "land-owning" subsidiary of appellant. Furthermore, the record reveals no distinguishing characteristics attributable to the Salarose tract which might support the conclusion that the tract constituted a separate "business" which terminated upon liquidation of Salarose. Although the tract may have been essential to the furtherance of the common business enterprise of the affiliated corporations, it was no more so than any other tract. In developing the tract, Salarose followed the same operating procedure, utilized the services of the same affiliated corporations, and employed the same key personnel as the other "land-owning" subsidiaries. Finally, it appears that either appellant or Shapell supplied the operating capital which the subsidiaries used to finance development of their respective tracts. Although the record is conspicuously silent with regard to this point, it seems highly probable that the cash transferred to appellant pursuant to the liquidation of Salarose was eventually used to finance the residential development of other property through new or existing subsidiaries. Under the circumstances, the election of appellant to liquidate and dissolve Salarose rather than continue its operation as a "land-owning" subsidiary does not provide a sufficient basis for concluding that the "business".of Salarose terminated upon its liquidation.

With respect to appellant's reliance on the decision of this board in Sunny Homes, we feel that the

facts and circumstances surrounding the corporate liquidations considered in that case were inadequately developed to afford meaningful comparison with the facts and circumstances presented by the instant appeal. For example, there was no indication in Sunny Homes that the residential real estate development business of the liquidated subsidiaries was carried on by their parent following the liquidations. In any event, to the extent that the decision in Sunny Homes is inconsistent with the decision reached herein, it is hereby overruled.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Woodbine Corporation, successor in interest to Salarose Corporation, against a proposed assessment of additional franchise tax in the amount of $69,748.70 for the income year ended September 30, 1970, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of September, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member